

**Economic Reforms in Ukraine: Situation and Perspectives**

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**Letter from the Publisher**

Traditional recommendations of the macroeconomic theory are insufficiently effective in many transitional economies, including Ukraine. Apparently, the above can partially explain slow pace of reforming Ukraine's economic system. However, the decade of economic reforms and transformations gives us ample grounds for a profound analysis of contemporary state of the national economy and discussion of new strategic and tactical goals of further reforms.

In this issue of the Economic Reform Today journal, Serhiy Tretyakov, deputy head of the State Committee for Regulatory Policy and Entrepreneurship, studies the existing system of licensing of economic activities in Ukraine. The author makes a conclusion that should our country establish optimal rules of licensing of economic activities, it will offer a powerful incentive to economic stability, development of entrepreneurship, especially the small business, reduction of the shadow sector and intensification of fight against corruption, which will finally settle social problems. The article by Serhiy Bereslavsky closely analyzes drawbacks and problems of licensing of economic activity to be solved.

Oleg Boiko-Boichuk, vice-president of the Ukrainian Association of Regional Development Agencies, addresses the strategy of the state regional policy in 2002. The author asserts that efficient realization of the state policy of regional development provides for effective functioning of regional development institutions founded with due regard to new economic conditions; establishment of feedback and constructive dialogue with regions; elaboration

of methodologies and procedures enabling national authorities to encourage and support regional initiatives in the field of social and economic reorganization.

In the opinion of Anatoliy Stupnytsky, one of the key methods for improvement of Ukraine's economic situation is large-scale restructuring of enterprises proving for their organizational, managerial, financial, technical and production accommodation of a production structure to constantly changing market conditions for the purpose of increasing efficiency and competitiveness of commodities.

Serhiy Maslichenko researches the problem of public governance at the current stage of social development. In the light of globalization processes, emergence of new economic entities and geopolitics, the role of the state will not weaken and will not be confined to control and supervision of compliance with general rules. On the contrary, under new circumstances, the state will play the most powerful and responsible role in protecting and safeguarding national interests.

Vladyslav Anin, winner of All-Ukrainian Contest of Young Economists, believes that formation of the social market economy model in Ukraine requires co-existence of the strong state and strong market. Hence, intensification of market orientation and market economic trends should be attended with enhanced social role of the state.

We hope that approaches and viewpoint proposed by the authors will be interesting for our readers.

*Faithfully yours,  
Maxim Latsyba,  
Publisher of the Economic Reform Today journal*

## **State licensing system of economic activities in Ukraine**

### **Serhiy Tretyakov**

**Serhiy Tratyakov** – candidate of technical sciences, deputy head of the State Committee of Ukraine for Regulatory Policy and Entrepreneurship

Procedures of state registration of economic entities and licensing of economic activities are **the determinant factors of business legalization**, i.e. its legitimacy. It is during the process of registration and obtaining licenses, when businessmen first contact public servants, administrative apparatus of ministries, departments, local authorities (there are more than 8 hundred of the latter in Ukraine!).

For transition countries (including Ukraine) is typical that one state body has powers related both to methodological management of registration procedures of economic entities and licensing of economic activities. This is connected, first of all, with the fact that a businessman is required to submit the same set of documents both for registration and obtaining a license (the statute, constituent treaty, references etc.). Moreover, registration procedures and granting licenses is done by the same officials (almost 80% of licenses are granted by local authorities – district administrations and district executive committees of councils of popular deputies. Here it should be mentioned that in Ukraine almost 80% of economic entities are registered by about 50% of registration institutions, i.e. the rest of them work inefficiently).

The licensing sphere comprises a number of matters related to filing and submission of the respective list of documents required for obtaining licenses, re-registration of licenses and passing certain amendments to them, as well as filing deeds of inspections as to compliance with licensing legislation and suspension and/or cancellation of licenses.

The registration procedures have been in the scope of executive authorities starting the soviet period already, while with the beginning of economic transition it has become clear that the licensing-related problems are absolutely new for Ukraine. For limitation (licensing) of economic activities has never been practiced before. And the licensing system is seen to be of high importance both for development of business and national economy on the whole.

Each country pays much attention to solving problems related to limitation of entrepreneurship. Thus, all developed European countries have common national institutions elaborating methodological backgrounds for licensing.

The following basic principles are central to the licensing system: proper qualification level for carrying out certain activities, prohibition from using licensing as a lever for limitation of competition, clearness and transparency of license conditions, care about people's health, environment protection and/or state security.

Licensing could be used as:

- repressive sanction;
- source of budget income at different levels (in fact, in the vast majority of European countries the fee for a license is just symbolic);
- means to protect the market from unfair competition (for instance, in some cases foreigners are not prohibited from some business activities, but at that, there are more rigid license conditions for them, for example, when passing tests in some educational establishments);
- source of corruption (it is typical for transition countries and is connected with poor legal regulation of some issues and unclearness as to responsibilities);
- means to provide for high quality of works and services;
- way of promoting dialogue between the state, local authorities and entrepreneurs (their unions, associations etc.), educational establishments, scientific research organizations etc.

Licensing procedures should be grounded and coherent, as expediency of limitations is conditioned mainly by social and economic factors. Accordingly, license conditions should be rigid and simple at the same time to be clear and transparent for businessmen.

So, both stability of the economic system of Ukraine and development of entrepreneurship itself (small businesses first of all), reduction of “shadow sector”, efficient struggle against corruption and finally – solution of social problems - will much depend on optimal rules of licensing of economic activities to be defined by the state.

*Security of the state social system, for instance, (as shows the experience of European countries) mainly depends on threats connected with natural disasters or certain human activities. Under certain unfavorable conditions these threats could materialize and come out in ruining for some individuals or national security in general.*

*Thus, in Ukraine the reasons of comparatively high death percentage among the population lie mainly in the social sphere. So, it is quite natural that there is a high risk of death from poisoning among the persons suffering from alcoholism.*

It should be mentioned here that the scope and directions of the state influence on economic processes depend on factors of political, economic, social, psychological character etc. In other words, ensuring efficient economic system envisages flexible system of the state interference in economic processes.

One of such influence guidelines is the existing permission-based system in the sphere of entrepreneurship, which consists of the set by the state special conditions (limitations) for carrying out certain economic activities.

*It should be understood under the permission-based system in the sphere of entrepreneurship the set of rules providing limitations (licensing) for some activities in entrepreneurship, except for permissions granted by law enforcement bodies (except for special rules for production, purchase, storage, transport, registration and use of some specific objects, materials and substances, as well as setting up and functioning of certain enterprises, workshops and laboratories in order to protect national interests and ensure safety of citizens, as provided by the Resolution of the Cabinet of Ministers of Ukraine dated October 12, 1992 No. 576 “On approval of provisions on permission-based system”).*

In fact, in 1992 the system of total limitation of economic activities (sometimes unreasonable) through issuing of a great number of documents of permission character regulating business activities was introduced in Ukraine. They included “permission”, “special permission”, “right”, “license”, “attest”, “certificate”, “certificate attest”, “voucher”, “identification card”. And all of them happened to be licenses in their essence.

It is this fact that brought about necessity of transition from the policy of “covering loopholes” (constant changes and amendments to the existent laws on licensing, which were considered by the Verkhovna Rada of Ukraine with delays) to elaboration of the unified law of direct action – the Law of Ukraine “On Licensing of Some Economic Activities”.

For today, the licensing system in Ukraine involves almost all 30 central executive bodies and all of 27 regional state administrations. Nevertheless, it still remains the system, where conflicts of interests between executive authorities and economic entities are not sporadic.

The state licensing of economic activities was first introduced by the legislation in 1991, when the Law of Ukraine “On Entrepreneurship” was adopted. That law provided for licensing of 12 economic activities only. The

licensing sphere was further developing chaotically having the only one tendency – of constant expanding. So was almost up to 1997. By that time almost 212 business activities and almost 1500 works and services were subject for restriction, i.e. almost everything was licensed!

Then all without exceptions executive authorities made efforts to provide for licensing of a greater number of activities and works. And only by the end of 1997 the law canceling licensing of a great number of economic activities and works was adopted. Since only 42 of them were subject for licensing.

Now, it is possible to compare the situation with development of entrepreneurship in Ukraine before 1997 and after it regarding the volume of licensing of economic activities, as well as conditions and rules of this procedure. Such comparison allowing to conclude the following:

- licensing of almost all economic activities did not anyhow improve the situation in entrepreneurship in Ukraine. Instead, it only shadowed it, as a great number of businessmen obtained no licenses at all;
- poorly formulated and nontransparent license conditions resulted in numerous violations of legislation (including those by executive authorities);
- the state budget annually failed to receive considerable amounts it could collect from granting licenses (a great number of state enterprises with self-sustained budget had powers to grant licenses).

Though even upon adoption of the said law many problems still remained unsolved. And the main problem consisted in impossibility to regulate the licensing system through passing numerous changes and amendments, because by that time working procedures with the Verkhovna Rada of Ukraine were rather complicated, besides there was a great number of legal acts regulating licensing (and almost all main provisions concerning licensing were set by laws). And up to October 22, 2000 (i.e. prior to enactment of the Law of Ukraine “On Licensing of Some Economic Activities”) the licensing sphere was regulated by 79 laws of Ukraine, 204 resolutions of the Cabinet of Ministers of Ukraine, 79 instructions and 61 acts passed by state departments (in total by 423 documents!).

The law on licensing dated July 1999 in accordance with the Decree of the President of Ukraine dated May 20, 1999 No. 539 “*On introduction of permission-based system in the sphere of entrepreneurship*” was elaborated with an eye to adjust permission-based system in the sphere of entrepreneurship. The Verkhovna Rada of Ukraine adopted that law on June 1, 2000.

The law does not regulate relations in international economic activities, as well as licensing of communication channels, electrical energy, use of atomic power and intellectual property. More wide sphere is defined as the object of licensing – economic activities, carrying out of which directly impacts human health, environment and state security.

For the first time certain considerable changes have been entered by the law in the existing licensing order of economic activities, namely:

1. Basic licensing principles of economic activities and criteria of functioning of the state licensing system have been defined.
2. The sphere of the law application has been expanded considerably, having covered both kinds of business and economic activities in general.

As, this law reads, an economic activity is any kind of activity, including business, practiced by legal entities and individuals-economic entities associated with production (manufacturing), trade, rendering services and works. Entrepreneurship, under the definition given by the law “On entrepreneurship” is an independent initiative of systematic character, activities at businessmen’s own risk associated with production of goods, carrying out works, rendering services and trade with the aim to get profit. Economic entities (entrepreneurs) could be citizens of Ukraine and of other states, whose legal rights or actions are not limited by the law, as well as, legal entities of different ownership, as provided by the Law of Ukraine “On Ownership”.

The concept of “economic entity” is defined by the laws of Ukraine “On Limiting of Monopoly and Prevention of Unfair Competition in Entrepreneurship”, “On Ensuring Economic Competition” and “On Licensing of Some Economic Activities”. Thus, the concept “economic entity” is more wide and comprises the notion of “business entity” or “entity performing business activities”. “Economic entities” include, for instance, non-profit enterprises, funds, associations of businessmen etc.

3. Clear and transparent mechanisms of handing in applications for licenses have been introduced, as well as, for obtaining, re-registration, cancellation of licenses etc. Since the Cabinet of Ministers of Ukraine has passed the

Resolution “On the order of licensing of economic activities” dated July 1998 all the mechanisms of implementation of the law provisions have been tested “in practice”.

4. The unified list of activities subject for licensing has been provided. For this, licenses for activities connected with use of limited resources will be granted on tender basis only.

5. The contents of *license conditions* has undergone principle changes: the law provides the comprehensive list of qualification or technological requirements, which are mandatory for carrying out of a certain activity, instead of listing conditions and rules for such economic activity.

6. The law reads that a license is the only document of permissive character in the sphere of economic activities.

7. The unified license form has been introduced on the territory of Ukraine (this is connected, firstly, with the fact that there have been numerous forgeries of licenses disclosed). The license form has 24 levels of protection (they are produced by the winner of a tender – “Ukraine” Kyiv polygraph house). At that, each form has its own number and series. Besides, in order to adjust the procedure of license registration, the law provides that the number of a license form is the number of a license. Thus, there will be no more misunderstandings with registration, as the number of forms equals the number of licenses. This allows proper maintaining of the Unified License Registry. Substitution of the old license forms with new forms is done according to requirements of clause 3 of article 24 of the Law of Ukraine “On Licensing of Some Economic Activities” and in the order as set by the Resolution of the Cabinet of Ministers of Ukraine dated September 26, 2001 No. 1246 “On approval of the order of substitution of license forms of previously issued licenses with the unified license forms”. Such substitution is provided to:

- Introduce the unified state licensing system and unified license forms;
- Present reliable information to the Unified License Registry;
- Introduce a controlling mechanism over earnings to the national budget of Ukraine received from license fees, as well as savings of state funds from printing license forms (now, one polygraph house annually prints more than 400 copies of unified license forms, it is 15-20 times cheaper than if there were printed by each of more than 50 licensing institutions).

For this it should be mentioned that under the Law of Ukraine “On Licensing of Some Economic Activities” licenses for some economic activities granted before this law has come in force (and licensing of which is provided by this law) are valid until the expiration of their terms (i.e. terms pointed in old licenses). Besides, the above-mentioned governmental resolution sets requirements towards licensing institutions, but not towards economic entities, that is:

- a licensing institution should perform free substitution of the old license form within five days;
- all without any exception licenses granted before the Law of Ukraine “On Licensing of Some Economic Activities” has come in force will be valid under the same conditions, and will be only re-registered by licensing institutions;
- forms of substituted licenses remain at disposal of an economic entity.

Judging this, licensing institutions should replace license forms without any disturbance of a licensee’s right for carrying out the licensed economic activity. When filling unified license forms in the case of substitution of license forms issued prior to enactment of the law on licensing, licensing institutions should follow the recommendations of the State Committee for Regulatory Policy and Entrepreneurship (the letter dated October 18, 2001 No. 4-432-1078/6227).

8. The problem of introduction of a uniform mechanism for granting, re-registration or cancellation of licenses, as well as the uniform procedure of taking decisions by licensing institutions as to granting or refusal to grant a license has been solved (terms of consideration of applications for licenses have been reduced from 30 to 10 working days).

9. Sub-licensing has been banned.

10. A new institution has been set up – the Expert-Appellate Council, as a permanent collegiate body for licensing-related issues only. This principally new institution is set up with an eye to promote the dialogue between the executive power, the public and economic entities, whose interests do not match often.

The Expert-Appellate Council has been set up at the State Committee of Ukraine for Regulatory Policy and Entrepreneurship by the Presidential decree. Its scope comprises expertise of draft legal acts of executive bodies as to licensing, elaboration of recommendations on main problems of the state policy in the sphere of licensing, presenting preliminary conclusions regarding propositions entered by executive authorities and local governments, institutions and organizations as to expediency of introduction or cancellation of licensing for some economic activities, consideration of applications, claims and complaints of economic entities against licensing institutions as to violation of licensing legislation by these institutions, analysis of the situation in licensing and elaboration of recommendations for improvement.



In order obtain consultations and examine the documents, the council has the right to involve state officials, researchers, representatives from civil organizations, associations, unions and other specialists. Besides, it is provided that independent experts and representatives from civil organizations in the council should make no less than 20 percent of the total of its members. The State Committee of Ukraine for Regulatory Policy and Entrepreneurship possesses certain experience in working with such organizations (since existence of the Licensing Chamber of Ukraine and its expert council).

The council membership has been approved by the governmental resolution dated November 8, 2000 No. 1669 “On Expert-Appellate Council at the State Committee for Regulatory Policy and Entrepreneurship”. Oleksandra Kuzhel, head of the State Committee for Regulatory Policy and Entrepreneurship is appointed to head the council. The State Committee for Regulatory Policy and Entrepreneurship is to provide for organization, information and technical facilitation of this institution. These functions are entrusted to deputy head of the council Serhiy Tretyakov, who is deputy head of the State Committee of Ukraine for Regulatory Policy and Entrepreneurship.

It is provided that the license is valid during the period of consideration of a claim by the council, unlike before (Thus, in 1999 almost 70% of licenses were suspended or cancelled without any ground!). Besides, earlier (i.e. till October 22, 2000) any official of the respective controlling institution could suspend a license by his own decision (i.e. to suspend activities of an economic entity under such license), thus a businessman found himself in a deadlock. Now, an economic entity has the right to lodge a claim to the council against activities of such official within 10-days term. Should the council find the decision of some official groundless, the latter will have to bear responsibility for his actions under the legislation in force.

Draft legal acts, as well as received by the council propositions and applications (appellations) will be considered within 20 working days since they are registered by the State Committee of Ukraine for Regulatory Policy and Entrepreneurship. According to the consideration results, the council takes decisions in the form of expert opinions. The council’s decisions should be further considered by the State Committee for Regulatory Policy and Entrepreneurship, and they are the basis for this committee to pass resolutions for removal of violations in the licensing legislation.

Under clause 7 of the Presidential Decree dated March 25, 2000 No. 721 “On the State Committee for Regulatory Policy and Entrepreneurship”, the decisions the Committee’s decisions are mandatory for execution by central and local executive authorities, local governments, enterprises, institutions, organizations of all kinds of ownership and citizens.

So, if you, dear readers, have your propositions as to regulation of the state licensing system of economic activities or suffer barriers when applying for licenses or carrying out your activities, you are welcome to send your letters the State Committee for Regulatory Policy and Entrepreneurship (04053, Kyiv, 73 Artioma Street, Expert-Appellate Council at the State Committee for Regulatory Policy and Entrepreneurship).

11. The system of license registration has been set on a new level – the law has introduced the Unified License Registry. Such registry was created by the License Chamber of Ukraine in 1997 already. For the time being its database includes almost 250 thousand licenses.

12. The legislation provides for one time payment for granting licenses (as the mechanism of realization of the European norm, under which a fee for a license is not a source of the national budget income). Nonetheless, such fee is to be paid by an applicant only upon a licensing institution takes a decision to grant a license. The fee amount and order of payment for a license will be determined by the government. Payment for a license will be transferred to the national budget.

By the way, many norms of this law were taken as a basis for the Russian law “On Licensing of Some Activities” dated August 8, 2001 and the respective law of Moldova on licensing of economic activities.

In order to fulfil the requirements of the law, the Cabinet of Ministers of Ukraine has already taken resolutions specifying the mechanism of licensing of economic activities.

1) “On approval of the order of filing, keeping and using of the license registry data and their submission to the Unified License Registry” dated November 8, 2000 No. 1658;

2) “On Expert-Appellate Council at the State Committee for Regulatory Policy and Entrepreneurship” dated November 8, 2000 No. 1669;

3) “On approval of the list of licensing institutions” dated November 14, 2000 No. 1698 (it empowers 30 central executive bodies to grant licenses for 60 economic activities, some state institutions – for 16 economic activities, the Council of Ministers of the Autonomous Republic of Crimea, regional administrations, Kyiv and

Sevastopol Municipal Administrations – for 4. Due to this the list of licensing institutions has been cut almost 15 (!) times – from 825 to 57);

4) “On introduction of a unified license form for certain economic activities” dated November 20, 2000 No. 1719;

5) “On validity terms of a license for certain economic activities, amount and payment order for granting such license” dated November 29, 2000 No. 1775 (it provides for the three year validity term of licenses for certain economic activities and a fee for licenses in amount of 20 tax-exempt minimal salaries of the citizens, if a license is granted by a central executive body, and 15 tax-exempt minimal salaries of the citizens, if a license is granted by a local executive body, except for activities associated with communications);

6) “On amending the list of licensing institutions approved by the Resolution of the Cabinet of Ministers of Ukraine dated November 14, 2000 No. 1698” dated April 28, 2001 No. 410 (it authorises the Ministry of Education and Science to grant licenses for production of CDs for laser systems);

7) “On the order of assigning a special identification code” dated April 28, 2001 No. 411 (for production of CDs for laser systems);

8) “On approval of the order for registration and transport across the Ukrainian borders of the goods containing products of intellectual property” dated April 28, 2001 No. 412 (for export/import of CDs for laser systems);

9) “On amending the resolution of the Cabinet of Ministers of Ukraine dated January 27, 1997 No. 65” dated April 28, 2001 No. 413 (on introduction of customs fees for registration of goods containing intellectual property products, for prolongation of registration terms and amendments to the registry of goods containing products of intellectual property);

10) “On approval of the regulation on the inspection commission for enterprises-manufacturers of CDs and rules of such inspections” dated April 28, 2001 No. 414;

11) “On approval of the list of the documents to be attached to an application for a license for a certain economic activity” dated July 4, 2001 No. 756;

12) “On approval of the order of substitution of the forms of previously granted licenses for unified license forms” dated September 26, 2001 No. 1246.

Besides, the President of Ukraine passed Decree “On amending clause 1 of the Regulation on the State Committee of Ukraine for Regulatory Policy and Entrepreneurship” dated March 5, 2001 No. 149, where the State Committee of Ukraine for Regulatory Policy and Entrepreneurship is defined as a special authorized body in the licensing sphere.

In the letter dated October 13, 2000 No. 01-8/493 the Higher Arbitrage Tribunal of Ukraine has notified all arbitration tribunals of Ukraine of the law regulations, which are to be followed when hearing disputes associated with licensing of economic activities. The letter inter alia pointed out the State Committee of Ukraine for Regulatory Policy and Entrepreneurship, as a special body for licensing issues.

On the initiative of the State Committee of Ukraine for Regulatory Policy and Entrepreneurship, the State Tax Inspection of Ukraine has disseminated the letter dated November 8, 2000 No. 14781/7/18-0317 banning sanctions against economic entities for non-licensed activities, until the respective legal acts regulating new economic activities is adopted.

Introduction of the mechanism for realization of the new law has outlined the range of current problems which urge solving.

- The Law of Ukraine “On Licensing of Some Economic Activities” does not regulate activities associated with whole and retail sale of alcohol drinks and tobacco goods. This has provoked developing of extremely negative effects (at that, none of the laws regulating transactions with alcohol and tobacco at present do not specify even the norms of license cancellation).

- Within half a year six amendments have been passed to the law. So, quite familiar tendency could be observed – growing number of activities subject for licensing. These activities include lotteries business, new building and educational activities, motor transport services. At the same time, production and trade in ethyl, cognac and fruit spirits, alcohol drinks and tobacco goods have been excluded from the law scope. Though no amendments to the said law that would specify licensing procedures have been passed.

- Amendments and supplements to the new law on licensing as to peculiarities in licensing of some economic activities (production and sale of optic disks, alcohol drinks, tobacco goods etc.).

- Attempts to exclude some activities from the scope of the Law of Ukraine “On Licensing of Some Economic Activities” – the only law of direct action specifying all licensing procedures – could be traced, namely transactions with securities, oil and gas, lottery business etc. This attempts could not be appreciated otherwise but as the efforts to provide economic entities with special and, as a rule, ungrounded conditions in these spheres.

- Some driving forces make efforts to “blur” the license system, through revising the set by the legislation new licensing system, aiming at introduction of additional and, as a rule, groundless requirements towards a licensee.
- Many state departments attempt to “push through” additional requirements for obtaining licenses. And thus, for the time being only 43 license conditions from 48 are registered by the Ministry of Justice. The rest are not approved because of their poor formulation by licensing institutions, first of all by the National Commission for Electric Power Regulation, State Customs Service, Ministry of Finance etc. And this happens despite clear requirements provided by the governmental resolution dated November 14, 2000 No. 1698 “On approval of the list of licensing institutions” and separate instructions of the Cabinet of Ministers of Ukraine!
- No responsibility for officials of licensing institutions has been provided.

In order to further improve the state licensing system of economic activities we consider it to be necessary to take urgent measures to ensure the following:

- Extension of the Law of Ukraine “On Licensing of Some Economic Activities” to economic activities, licensing mechanisms for which are regulated by the special laws of Ukraine. Thus, licensing peculiarities for certain sphere of activities could be regulated either by a special law, or should be specified by the Law of Ukraine “On Licensing of Some Economic Activities”;
- Introduction of the principle of priority of the norms set by special laws specifying peculiarities of licensing for some economic activities over the general norms of the Law of Ukraine “On Licensing of Some of Economic Activities”;
- Providing for administrative or criminal responsibility for failure to comply with the requirements of the licensing legislation;
  - Mandatory discussing of draft legal acts by civil organizations;
  - Mandatory publication of draft license conditions for certain economic activities (this requirement has been partially realized on the web site of the State Committee of Ukraine for Regulatory Policy and Entrepreneurship: [www.dkrpp.gov.ua](http://www.dkrpp.gov.ua), [www.lpu.gov.ua](http://www.lpu.gov.ua));
- Creation of a global licensing network (the Unified License Registry), which would have links with other state registries of Ukraine associated with entrepreneurship sphere;
- Expansion of the powers of the State Committee of Ukraine for Regulatory Policy and Entrepreneurship, being a special authorized body in the licensing sphere, as to imposing fines, adjusting draft legal acts on licensing etc.;
- Setting up the Expert-Appellate Council subdivisions in regions;
- Regulation of the permission-based system in the sphere of economic activities, particularly, introduction of the application principle for granting permissions for activities, which are not subject for licensing under the legislation (first of all, in retail sales);
- Publication of all license conditions and rules (the State Committee of Ukraine for Regulatory Policy and Entrepreneurship has already edited a “Manual on licensing of economic activities” having 350 pages).

Finally, I would like to emphasize on the fact that despite certain difficulties existing in the country, the new and harmonized with the respective European norms licensing system of economic activities is being introduced.

### **Licensing of some economic activities: pros and cons**

**Serhiy Bereslavsky**

**Serhiy Bereslavsky – expert at the Institute for Competitive Society**

Stages in development of the domestic licensing system of economic (business) activities have been determined both by changes of criteria for introduction of licensing for separate activities and conceptual approaches to licensing procedures themselves.

It should be mentioned that the criteria for introduction of licensing for specific economic (business) activities (influence on health of individuals, environment, state security) were first outlined by the Concept of development of the state licensing system of business activities accordingly to their types approved by the Resolution of the Cabinet of Ministers of Ukraine dated September 23, 1996 No. 1164, whereas from the very moment of introduction of licensing (starting March 1, 1991) to the mentioned date there were no such criteria at all.

The last but one change in the licensing system of economic (business) activities was made in 1998, when the Law of Ukraine “On Amending the Law of Ukraine “On Entrepreneurship” dated December 23, 1997 No. 762/97—VR came in force. At that time the licensing system possessed some features, which either blocked or served for



emerging of obstacles to economic entities to enter different markets and their further activities in this markets. In particular, such features included:

- 1) permission-based licensing, particularly, preliminary inspection of an applicant' activities as to compliance with the license conditions;
- 2) special licensing procedures provided by special laws, which came in conflict with the general provisions regulating licensing specified by article 4 of the Law of Ukraine "d
- 3) different fees for licenses depending on the activity for which a license was granted and a licensee' legal status;
- 4) absence of the uniform order of control over observing license conditions; the order of such control was determined regarding the specifics of each separate business activity subject for licensing, as well as arbitrary interpretation of such notions as "repeated violation " and "outrage" of license terms, which could result in ungrounded cancellation of a license;
- 5) constant changes in the list of business activities which were subject for licensing (mainly its expanding);
- 6) lack of guarantees for securing rights and lawful interests of economic entities in the licensing sphere, inefficiency of mechanisms for their protection in case of violations;
- 7) impossibility for citizens to participate in generating of the domestic licensing system.

The last and the most radical change in the licensing system of economic activities was done in order to solve these problems – adoption of the Law of Ukraine "On Licensing of Some Economic Activities" dated June 1, 2000 No. 1775—III.

The current licensing system of economic activities includes the following components:

- licensing ideology;
- list of economic activities subject for licensing;
- order of licensing;
- license conditions;
- institutions providing licensing (the Cabinet of Ministers of Ukraine, the State Committee for Regulatory Policy and Entrepreneurship (SCRPE) being a special authorized body for licensing matters, licensing institutions, the Expert-Appellate Council at the SCRPE);
- guarantees for securing rights and lawful interests of economic entities.

For this, such components as the list of economic activities subject for licensing, order of licensing and license conditions appear to be under high risk because of their vulnerability to possible deformation of licensing ideology under the pressure of external factors. At the same time, the licensing ideology is formed both by basic principles of the state policy in this sphere, as stipulated in article 3 of the Law of Ukraine "On Licensing of Some Economic Activities" and the principles, which are not qualified by the legislation clearly or are not qualified at all, but they are still implicated by persons involved in making the state policy in this sphere. The latter, for instance, include the principles of non-fiscal licensing and inadmissibility to make inspection of an economic entity at its location place as to compliance with the license conditions prior to the moment it obtains the license itself. These principles are certainly initial ones, i.e. they influence development of other elements of the current licensing system.

Unfortunately, even the fixed by the law main principles of the state policy in licensing are not pursued coherently. And the further lawmaking activities have proved that each of these principles has at least one exception.

Thus, the principle guarantying equal rights and legal interests for all economic entities has been violated when determining license conditions for medical practice. Under clause 1.4 of the License conditions for medical practice approved by the Resolution of the SCRPE of Ukraine and the Ministry of Health Care of Ukraine dated February 16, 2001 No. 38/63, the right to carry out specific activities according to medical specialties has been geared to the ownership form of a health care institution and legal status of an economic activity. Therefore, private health care institutions and economic entities – individuals have been unreasonably deprived of the right to render a number of medical services, though such the limitation is not provided by the norms of Ukrainian laws and other legal acts (except for prohibition from performing the functions pertaining to the state sanitary control service).

The principle of introduction of the uniform order of licensing of economic activities on the territory of Ukraine is aimed to prevent emerging of any kind of special procedures for licensing of economic activities depending on some peculiarities in their practicing. Unfortunately, the Law of Ukraine "On Licensing of Some Economic Activities" itself provides for an exception from the above principle, namely requirement to obtain license cards for each motor vehicle, when obtaining licenses for passenger carriage and cargo transport services by public transport, as well as passenger carriage and passenger luggage by taxi.

Here, it should be qualified that the uniform order of licensing is applicable only for economic activities, which are specified by article 9 of the Law of Ukraine “On Licensing of Some Economic Activities”. Therefore, this principle, as well as the others could be side-stepped by way of excluding some economic activities from the scope of the Law of Ukraine “On Licensing of Some Economic Activities”. In particular, in such a way special procedures for licensing of economic activities associated with production and trade in ethyl, fruit and cognac alcohol, alcohol drinks and tobacco goods and insurance services have been introduced. However, these economic activities have no specifics of the kind that could make their licensing under the general provisions of the above law impossible.

In the Ukrainian licensing system the accent has been made on granting the right to carry out certain economic activity, rather than on limitation of a number of economic entities, which could work in some markets of goods or services. This corresponds to one of the principles of the state policy in the licensing sphere, namely, banning to use licensing for limitation of competition in business. The mentioned principle should be realized through ensuring conditions for economic competition as well.

With this aim, article 1 of the Law of Ukraine “On Licensing of Some Economic Activities” prohibits state authorities and local governments from practicing economic activities subject for licensing. This, first of all, should avoid possible conflict of interests between a licensing institution carrying out some economic activity, for which it has been authorized to grant licenses, and other players in the market. In order to ensure conditions for economic competition, the object of licensing was changed as well. Whereas article 4 of the Law of Ukraine “On Entrepreneurship” has provided for licensing of certain business activity, from now, the object of licensing is a certain economic activity, which includes activities of legal entities that are not registered as economic entities. This provides for equal conditions in spending of funds and time for obtaining licenses, as well as adhering to license conditions and license control both for economic entities and those legal entities, which have received no licenses prior to enactment of the Law of Ukraine “On Licensing of Some Economic Activities”, despite that they actually have practiced business activities subject for licensing.

The fact that obtaining a license no more depends on the scope of special legal powers of a legal entity may seem insignificant from the first glance. I.e., earlier, when obtaining a license, the law required from all applicants to submit copies of statutory documents to licensing institutions, which checked compliance of the statutory activities of an economic activity with business activity, for which the license was granted. Now, the copies of statutory documents are required when obtaining licenses for only 16 economic activities.

According to ideological backgrounds of the law on licensing, a fee for granting a license is a one-time payment to be made by an economic entity for administrative services. Therefore, the amount of this payment should correspond to the size of actual organizational expenses connected with granting a license and keeping a license registration case of a licensee. As the law has unified the process of granting licenses, organizational expenses for this administrative service has become approximately even. Thus, the fee for a license should be the same for all economic entities. Regarding this, the payment for granting a license loses its fiscal character and can not be a financial obstacle to entering the market.

Unfortunately, when specifying the list of economic activities subject for licensing, such a basic principle of the state policy in licensing, as protection of rights, legal interests, life and health of citizens, environmental protection and state security, has not been followed. As the result, some activities, which do not influence the mentioned aspects directly, were included in the above list (for instance, trips (excursions), physical culture and sport activities).

Besides, the approach to licensing, as the means of state influence on the sphere of economic activities, is seen troublesome. Such influence is always referred to, when efforts to expand the state control over less controlled markets are concerned (among the latter in terms of such an approach – attempts to introduce licensing for activities associated with production of CDs for laser devices and internet services).

The law on licensing clearly specifies and determines the order of licensing procedures, and this is seen a significant advantage of the existing licensing system. Due to this, this order has become quite transparent and understandable to economic entities. Besides, it has got a number of innovations aimed at adhering to the licensing logic. It also prevents setting additional requirements for economic entities by licensing institutions. In particular, these innovations include:

- entitling an economic entity to submit documents for obtaining a license not only personally, but through his authorized agent (an institution or person);
- preventing groundless rejection of an application for a license without its consideration, as the law clearly specifies grounds for such actions;

- revocation of the procedure of a license cancellation or renewal, as well as, its prolongation (earlier, for a businessman legal effects of suspension and prolongation of a license were almost the same, as those connected respectively with cancellation and obtaining a license. And cancellation of a license for violation of license conditions happened to be in many instances groundless).

It is of absolute importance that the norms of the mentioned law, which determine the order of licensing, are the norms of direct action (except for the norms setting the order of control over compliance with the licensing legislation and license conditions by licensees).

All these factors determine certain self-sufficiency of the existing licensing order, i.e. changing the basic provisions of the licensing order is possible only through introduction of a new different order of licensing.

Nevertheless, this does not eliminate a possibility to improve some regulations in licensing procedures. Inter alia the term for submission an application for redrafting a license by an economic entity should be extended, at least in the case, when this redrafting is to be done in view of changing the name and location (residence) of an economic entity (now this term makes 10 working days). It should be mentioned that along with redrafting of a license, in case of changing its name or location (residence), the economic entity is to carry out a number of procedures connected with re-registration and submission of new information to registration (accounting) files with other institutions, which provide for external legalization of this economic entity. Such a great number of mandatory procedures that are to be performed within a short span of time exposes an economic entity to the risk of failing to redraft the license within the set terms, which could result in cancellation of the license under the law.

Furthermore, the current licensing order provides for unjustified highly centralization of functions in licensing. This is manifested by the fact that local executive authorities are entitled to grant licenses for four economic activities only, i.e. for the same number of activities as prior to enactment of the Law of Ukraine “On Licensing of Some Economic Activities”. If to add that the majority of licensing institutions – central executive authorities – have no territorial subdivisions and thus, they can not delegate their authorities in the licensing sphere to regional bodies, this, first of all, entails a problem of expenses to be born by economic entities for trips to Kyiv in order to obtain or redraft licenses. As to licensing institutions themselves - this hampers efficient control over licensees as to compliance with license conditions. These problems could be solved through providing for growing decentralization of the licensing system, i.e. delegating either specific or full powers in licensing of economic activities to local authorities.

One of the tactic objectives of the licensing system reformation was to prohibit inspection of an economic entity by inspectors at its location place as to compliance with license conditions prior to granting a license. In general, this has been achieved, though there are still some exceptions. For instance, the mandatory condition for granting a license for collecting and reprocessing of metal scrap of ores and ferrous metals is a deed filed upon examination of each special enterprise or special metal processing plant or its storage place pointed in the application for such license as to compliance with the requirements set forth by the Law of Ukraine “On Metal Scrap” (such examination is to be done by local state administrations). And upon such examination a reference issued by the Ministry of Health Care of Ukraine or institution authorized by it could be required as to the state of material-technical base of an economic entity, as well as availability of the legal documents required for certain economic activity. The same reference is also to be submitted when obtaining licenses for medical practice, use of donor blood and its components, production of medical remedies from blood and its components.

Some other violations of the licensing logic include:

- providing sub-licensing for four economic activities, i.e. demanding from an economic entity intended to carry out certain activity to a license for some extra activities;
- empowering two licensing institutions to grant licenses for the same economic activity, namely carrying out of disinfection, disinsection, deratization works (this is the single case). The State Department of Veterinary Medicine is to perform the functions of a licensing institution for the said activity, if it is carried out at places subject for veterinary control. For all other places (objects), where such activities are carried out, licenses will be granted by the Ministry of Health Care of Ukraine. At that, the legislation does not specify the objects of veterinary control, which results in uncertainty, as to when one should apply for a license to the State Department of Veterinary Medicine and when to the Ministry of Health Care of Ukraine. As the matter of fact, when performing disinfection, disinsection, and deratization works at all objects whatsoever one will be required to obtain two licenses from two licensing institutions and for this – to submit two different sets of additional documents.

These violations of the licensing ideology are possible to remove, though there could be more new ones of the similar kind. As their reasons remain unchanged, namely, actual introduction of the permission principle in licensing of the majority of economic activities by the Resolution of the Cabinet of Ministers of Ukraine dated July 4, 2001 No.

756 “On approval of the list of documents to be attached to an application for a license for separate economic activity”. The permission-based licensing order is rather complicated for an economic entity. At that, it unnaturally combines rigid licensing control and wide opportunities to comparatively easy deprive a licensee of the right to certain activity, which is typical for licensing based on the application principle. Thus, no domination of application-based licensing principles over permission and contest-based (tender) principles was achieved, though such prognoses were voiced when adopting the Law of Ukraine “On Licensing of Some Economic Activities”.

During adoption of the mentioned law the approach towards license conditions was revised as well. Under the Law of Ukraine “On Licensing of Some Economic Activities” these conditions should comprise an exhaustive list of organization, qualification and other specific requirements, which are to be fulfilled when carrying out economic activities subject for licensing. Therefore, this comprehensive list of requirements should be set *taking into consideration* the requirements set forth by the laws of Ukraine. I.e. licensing conditions can include some other requirements, which are not directly specified by Ukrainian laws. In such a case there is a risk of setting certain license conditions, which would limit the constitutional right to carry out certain activity, which is not prohibited by the law, or would create unjustified restrictions for entering the market. Thus, it is of high importance to arrive at balance between licensing objectives, being the way of state regulation, and the principle of law priority. If this balance in license conditions is violated, then, there could be such conditions, when a drug store or a drug storage place would be required to get state accreditation within one year since obtaining a license (disregarding the fact, that under the legislation drug stores are required to get state accreditation once in three years). Or either economic entities occupied in building would be required to comply with ISO 9000 standards, i.e. international standards, which are of voluntary character.

Besides, licensing conditions should not only refer to and demand adherence to legal acts (as compliance with regulations set forth by these acts is mandatory for businessmen anyway), but specify certain requirements. On the other hand, elaboration of licensing conditions is technically complicated, as it envisages working with a great number of legal acts and prompt changing of license conditions according to changes in other legal acts. Nonetheless, this task could be expedited: licensing conditions should include not the requirements, which would regulate economic activities on the whole, but only those ones, fulfillment of which would allow to reduce or eliminate risks associated with some economic activities, thus providing for reaching the goals declared at introduction of licensing for such economic activities.

A new institution dealing with licensing issues has been included in the licensing system by article 7 of the Law of Ukraine “On Licensing of Some Economic Activities” – the Expert-Appellate Council at the State Committee for Regulatory Policy and Entrepreneurship of Ukraine. The Expert-Appellate Council is *inter alia* a mechanism for non-tribunal protection and restoration of violated rights of economic entities in the licensing sphere. Along with this, it is the body, which carries out examination of draft legal acts on licensing, assess expediency of introduction or cancellation of licensing of certain economic activities.

Non-tribunal disputing of claims at the Expert-Appellate Council is seen an advantage for an economic entity. If a claim is lodged within the set term, the decision of a licensing institution to cancel a license will be suspended until the State Committee for Regulatory Policy and Entrepreneurship of Ukraine takes its own decision regarding the claim, whereas disputing of the claim before a tribunal does not suspend such decision. Besides, disputing of a licensing institution’ decision before a tribunal will demand certain expenses from a plaintiff, whereas consideration of the claim in the session of the Expert-Appellate Council envisages no expenses. Nonetheless, if the Expert-Appellate Council decides in favor of an economic entity, the latter will still need to apply to a tribunal, if it intends to cover the losses incurred because of illegitimate actions of the licensing institution.

One should pay attention that article 7 of the Law of Ukraine “On Licensing of Some Economic Activities” is applicable to licensing of economic activities included in the article 9 of this law, as well as to separate economic (business) activities which are licensed by special laws. This means *inter alia* that the powers of the Expert-Appellate Council are not limited only by economic activities subject for licensing under the Law of Ukraine “On Licensing of Some Economic Activities”.

The law reads that representatives from civil organizations and independent experts in the Expert-Appellate Council should constitute no less that 20 percent of the total of its members, which ensures presenting interests of the business community as to different issues considered in the sessions of this body. Major share of claims lodged by economic entities is connected with violations of two aspects by licensing institutions – granting and canceling of licenses. At the same time, the practice of the Expert-Appellate Council evidences that the vast majority of its decisions is taken in favor of economic entities.

Successful state policy in the licensing sphere will depend on how coherently the licensing ideology will be followed in future, provided that there will be equal conditions for all economic entities (regarding the specifics and the powers of other institutions etc.). With respect to this aspect, the role of the State Committee for Regulatory Policy and Entrepreneurship of Ukraine, being a special authorized institution in the sphere of licensing, and of the Expert-Appellate Council is central.

Therefore, the following problems are seen as urgent:

- monitoring of efficiency of licensing of some economic activities and tracing achievement of the objectives declared at its introduction, as well as cancellation of licensing of these activities, if necessary (though defining criteria of success or failure remains technically complicated);
- maximally possible abridgement of the list of documents to be attached to an application for a license for some economic activities, as well as promoting the application-based principle in licensing of certain activities.

Solving some other problems hereto could be defined as medium-term and long-term objectives.

### **Eight Problems of Reforming Local Financial Funds and Inter-Budget Relations in Ukraine**

Igor **Burakovsky**

By Igor **Burakovsky** - Doctor of Economics, Professor at the National University "Kyivo-Mohylyanska Academy", senior economist at the Kyiv "East-West" Institute Center

On June 21, 2001, the Verkhovna Rada adopted the Budget Code, which initiated the new stage of development of inter-budget relations in Ukraine. As a matter of fact, the Code established absolutely new rules of formation of local budgets and relations between national authorities and regional bodies.

It should be mentioned that on December 13, 2000, the Cabinet of Ministers of Ukraine passed the resolution on the procedure for formation of local budgets. The document provided for introduction of normative approach to calculation of amounts of transfers to the national and local budgets. The resolution paved the way for the reform of inter-budget relations.

Apparently, it will be possible to make a profound analysis of implications of the introduced Budget Code in the sphere of inter-budget relations only after a definite period of time, subsequent to approval of the Budget Code for 2002<sup>1</sup>. So, it is necessary to pay our attention to numerous systemic problems in the sphere of inter-budget relations evoked by enactment of the Code. Prior to discussing those issues, it would be expedient to enumerate the most positive aspects of the Budget Code in the sphere of inter-budget relations<sup>2</sup>.

Firstly, the whole number of taxes and duties (17 types) that will not be considered in the process of calculation of the amount of inter-budget transfers shall be transferred to local budget as proceeds. The above means expansion of a revenue basis of respective authorities. Hence, circulation of a certain share of financial flows will be organized at the local level, which is very important, especially taking into account traditions of concentration of enormous power and giant capitals in the hands of national authorities.

Secondly, the Code assigned seven taxes and duties to local budgets and set the respective amount of proceeds from those mandatory payments. For instance, except for other taxes and duties, Article 64 of the Budget Code assigned the income tax to local and regional budgets. According to Article 65, the income tax shall be distributed in the following proportions: the cities of Kyiv and Sevastopol – 100% of the overall amount of the income tax proceeds, budgets of cities and towns – 75% of revenues from the income tax levied on citizens living on those territories, budgets of districts, villages and territorial communities – 25% of the income tax receipts and regional budgets – 25% of tax proceeds. Undoubtedly, such a clearly defined scheme is an imperative factor of stabilization of local budgets in the context of medium- and long-term planning.

Thirdly, apart from issues relating to the budget process, the Code prioritized some significant directions of activities of local bodies. The matter of question is permission to make internal loans as well as foreign ones provided that population of a respective region exceeds 800,000 people.

Of course, in the context of experience of Odessa, national authorities will make efforts to establish the most rigid procedures for making such loans, though this opportunity should not be disregarded at all. Furthermore, in some Ukrainian cities and towns such experience proved to be a success.



Fourthly, the Code clearly indicated powers of state authorities at a variety of levels in the field of use of public funds. The above paved the way for rationalization and effectiveness of the budget process at all its stages and provision of transparent circulation of financial resources.

Fifthly, a positive aspect of the new system is the fact that, from now on, calculation of local and inter-budget transfers became transparent not only for national but also for regional authorities.

Sixthly, Article 27 of the Budget Code establishes a procedure for presentation and consideration of drafts influencing on budget revenues or expenditures. Such drafts shall be promulgated till August 15 of the year preceding the planned one. Otherwise, rules of respective laws and regulations will be applied not earlier than at the beginning of the budget year following the planned one. This provision serves as a guarantee for stability of local budget revenues formed on the basis of appropriate allocations of national taxes disposed of respective local bodies.

It is necessary to mention Article 78 of the Code. According to it, after enactment of the law on the national budget of Ukraine, government agencies and their officials are prohibited from making decisions resulting in emergence of new budget liabilities of local budgets not secured by budget allocations and without identification of sources of funds earmarked by the state for fulfillment of those liabilities. This Article can also be viewed as a guarantee for stability of local budgets.

Seventhly, special attention should be paid to Article 103. This Article calls for introduction of changes in the law on the national budget of Ukraine for the current budget period. Those changes shall envisage granting subventions so that to compensate lost receipts of local budgets as a result of providing tax privileges by the state, which lead to reduction of their revenues. The Article forms necessary legal preconditions for respective activities of those local authorities, on the territory of which enterprises that received privileges are located. Therefore, it is not possible to rule out the situation, when cities/towns will try to take advantage of the above provision.

Actually, the new system of inter-budget relations will be introduced from January 1, 2002 onwards, when legal documents relating to the right of state authorities at a variety of levels to make loans and regulating proceeds and expenditures of local budgets, the procedure for their approval and implementation and a mechanism for transfers and subventions to local budgets from the national budget of Ukraine.

Since the mechanism for relations between the national and local budget has not been put into effect yet, the Code indicated some preventive measures. For instance, within five years after adoption of the Budget Code, it will be possible to use inter-budget transfers from the national budget of Ukraine so that to bridge the gap between local budgets caused by inefficient activity of budget agencies network.

As a matter of fact, the Code incorporates numerous drawbacks, some of which are obvious even nowadays, while others will be manifested afterwards. However, we should not forget that this document represents just a sort of a compromise between the government, parliament and local authorities. So, like every compromise settlement, the Code has certain weak points.

In the budget sphere, the year 2002 will be characterized by establishment of direct relations between the Ministry of Finance and the Autonomous Republic of Crimea, regions, cities of Kyiv and Sevastopol, districts, towns and villages. In practice, it will mean making up of 686 local budgets. Hence, the so-called basic local budgets will become participants in the budget process.

Analysis of the documents of the Ministry of Finance attached to the draft “On the National Budget of Ukraine for 2002” leaves us with an assumption that the next year, the state will attempt to implement the following objectives in the field of inter-budget relations:

- Improve distribution of inter-budget transfers on the basis of calculation of the amount of expenditures for individual branches, which will be considered in calculation of the amount of subsidies allocated for leveling disproportions between local budgets
- Ensure mutual interests of district and regional authorities in mobilization of national taxes and duties and their impact on subsidies for leveling that are to be granted to local budgets
- Improve mechanism for mechanical remittance of transfers from the national budget to 686 local ones etc <sup>3</sup>.

Even superficial analysis of the Budget Code and predicted implications of its introduction (it is obvious that concrete conclusions could be made, at least, in a year) offers an opportunity to distinguish the whole number of problems, whose solution is vitally important for further reforming the budget sphere.

Firstly, it should be emphasized that the Code cannot resolve all problems of Ukrainian local budgets. Moreover, its efficiency depends on the legal basis for functioning of the budget system. The matter in question is the Taxation Code that shall prioritize principles and goals of the new taxation system of Ukraine. Even today, it is quite clear that changes in the taxation legislation, especially in rates of the income tax, can affect the amount of revenues of local budgets. At the same time, scales and directions of those changes will depend not only on the taxation legislation but also on other factors, such as scales of economic activities (economic development and its tempo), interest or indifference of citizens in legalization of their shadow incomes, state policy in the sphere of support for various industries, inclusive of various tax privileges, etc.

Should the state stimulate respective branches and industries, impact on local budgets will have purely regional distinction.

Secondly, the reform of inter-budget relations highlighted yet another problem usually suppressed at both political and expert levels, i.e. the issue of optimization of the number and activities of budget agencies and institutions, unevenly distributed among participants of the budget process. This problem is of both political and social nature but it can hardly be settled without adequate regulation of the social sphere at various levels of state and local power.

Thirdly, alongside with decentralization, the new system engendered a rather strong dependence of regions on the state in the budget process.

In my opinion, at present, this dependence is represented by the following forms:

Adoption of the Budget Code by Ukraine's parliament requires approval of local budgets. On the one hand, from now on, traditional "manual" budget governance will be impossible without violation of the Budget Code, which potentially calls for enhancement of budget discipline on the part of national authorities. On the other hand, political debates about the budget and delay in its enactment can paralyze the budget process in regions

Although the Budget Code requires the national budget to be based on realistic macroeconomic indicators, their forecast is not satisfactory in Ukraine. It is understood that mistaken calculations being a basis of the national budget will inevitably adversely affect effectiveness of local budgets. It is also necessary to accentuate that economic forecasting at the local level is actually absent and therefore economic guidelines remain extremely important

There is a realistic threat of introduction of changes and amendments to the Budget Code, especially in the Section regulating stability guarantees, should we take into account the fact that in Ukraine, major economic laws are constantly experiencing numerous changes

The Treasury will be responsible for execution of cash receipts and expenditures for the purpose of ensuring more effective control over circulation of budget funds. In general, the above approach is correct but it is necessary to clearly determine responsibility of this body for execution of its duties and functions and eliminate any possibility of its transformation into a purely bureaucratic structure

Fourthly, under new circumstances, the problem of uneven social and economic development of regions looks differently. From now on, this problem will contain some new aspects. Region-exporters will find themselves in a more complicated situation, for they will have to reimburse the VAT from local taxes.

Today, executive power is able to more freely maneuver in the field of calculation of normative figures of budget funds, mechanisms for encouraging administrative units having higher fiscal indicators as compared to other regions and territories. No doubt that the above could entail decrease of the level of forecasting revenues of local budgets and adversely affect their credit ratings. Hence, it is expedient to regulate those issues by laws instead of legal documents of executive power<sup>4</sup>.

In depressed territories, proceeds from taxes and other mandatory payments imposed on commercial and production activities will be lower than those in economically active regions. In this respect, it is necessary to search for optimal combination of budget instruments and mechanisms of regional policy. It is impossible to reach the aforementioned goal without clear legal definition of a depressed region/territory.

Fifthly, inter-budget relation reforming will be efficient only subject to calculation of optimal proportions of distribution of budget receipts between individual units of Ukraine's budget system and ultimate realization of the administrative reform geared toward establishment of optimal administrative and territorial division as well as precise identification and segregation of powers of national authorities and local self-government bodies.

In other words, the existent administrative and territorial division essentially hampers reforming of the public financial system. In brief, being guided by criteria of available financial resources of territories and effectiveness of governance, including that of the budget process at a variety of levels, the Ukrainian government must optimize the number of administrative and territorial units.

Sixthly, it is necessary to remember that introduction of any new approaches to the budget process will not necessarily result in increase of revenues but will only represent an instrument of distribution of budget funds. Therefore, in the event of their insufficiency or total deficit, methodologies for setting priorities of use of budget funds and assessment of its efficiency have been worked out long ago.

The above issue is especially important due to introduction of program purpose-intended method for, or rather approach to, use of budget funds. It is understood that a program approach will remain of purely declarative nature without clear definition of goals and objectives of such programs, methods for monitoring of their implementation and tools for assessment of results, whereas in practice, budget funds will be spend traditionally.

Seventhly, provision of more financial independence to local bodies requires elaboration of scientific and methodological principles of and approaches to objective assessment of social and economic situation in regions, different processes occurring on their territories and their taxation potential on the whole.

At the same time, it is rather complex to work out the above approaches and principles, since some parameters of respective processes can be beyond influence of a region.

Eighthly, for the time being, problems of relations between the national and 686 local budgets are solved rather effectively. However, relations between districts and cities, towns and villages still remain unsettled. The process of elaboration of regulations for budgets of towns and villages as well as calculations of their receipts and expenses has just begun. The Budget Code provides for enactment of a respective law only within two years <sup>5</sup>. In my viewpoint, detailed analysis of experience of this year relating to adoption of the 2002 national budget should precede development of such legal documents.

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Effectiveness of further efforts to improve governance of public financial resources at both the national and local levels depends on the reform of power in Ukraine. First and foremost, the matter of question is reforming activities of government agencies related to national budget proceeds. In many countries, taxation and customs services are directly subordinate to Ministries of Finance, whereas in Ukraine, they are independent from this body. As a matter of fact, such independence has its positive and negative aspects. That is why the issue of optimal system of state authorities responsible for governance of public finances requires an in-depth analysis and cannot be solved without due regard to a definite economic and political situation in Ukraine.

Apparently, the new system of local budgets and inter-budget relations will perform its functions only subject to stability. I believe that such stability can be ensured by the following four factors:

- Stability of assigned revenues (the list of taxes and allocation rates)
- Stability of the taxation system (the list of taxes and their rates)
- Stability of the economic situation in the country on the whole and in a region in particular
- Stability of budget mechanisms (procedures and formulas)

It is impossible to discuss stability and prediction of inter-budget relations without compliance with the above rules. Meanwhile, this does not mean that those principles shall remain unchangeable: the rules must be corrected for the purpose of improving them but the system must be maintained.

As we can see, almost all guarantees are beyond impact of local communities, except for a certain share of local taxes and duties and opportunities to influence the economic situation in regional markets. The above puts forward even more severe requirements to functioning of the state as an institute of power, especially of its national authorities.

## References

<sup>1</sup> At the moment of writing this article, the law on the national budget for 2002 has not yet been signed by the President of Ukraine.

<sup>2</sup> This article cites respective provisions of the Code and the publication of the Ministry of Justice of Ukraine: the Ukrainian Budget Code. Kyiv. The Publishing House “De Jure”. 2001.

<sup>3</sup> S. Ilyinykh. Forecasted Indicators of Local Budgets for 2002 and the Inter-Budget Relations. The Financial Analysis Task Force at the Budget Committee of the Verkhovna Rada. 2001.

<sup>4</sup> Y. Hanushchak. The Code of the “Budget Grammar”. The Zerkalo Nedeli (the Mirror of the Week). October 20-26, 2001. No. 41 (365).

<sup>5</sup> The same source.

## **Some Thoughts about the State Regional Policy Strategy in 2002**

Oleg **Boiko-Boichuk**

By Oleg **Boiko-Boichuk** - vice-president of the Ukrainian Association of Regional Development Agencies, Doctor of Engineering

Traditional recommendations of the macroeconomic theory are insufficiently effective in many transitional economies, including Ukraine. Apparently, the above proves that those states do not traditionally perceive the notion of economic development often referred to as “macroeconomic stabilization”, “liberalization of prices and markets”, “privatization”, “restructuring”, “institutional development” etc.

Analysis of experience of transitional economies leaves us with an assumption that **the progress of “in-depth” transformations strongly depends on divergence of regional structures of their economic systems**. In this respect, state economic policy **will be much more effective, if it takes into account a regional factor**. Hence, it is possible to state that efficient regional policy can serve as **a key to social stabilization**.

Ukrainian state authorities prioritized **policy of regional development** after its approval by the Yushchenko government’s **Reforms for Welfare** Program followed by the May 2001 presidential decree “**On the Concept of the State Regional Policy**”. The above priority of the state policy indicates prevalence of a new vision of Ukraine’s development, impact of domestic social, cultural and economic contradictions on the future of our country, understanding of the facts that all systemic transformations finally take place in regions and that successful implementation of any program is impossible without close cooperation of national authorities with regional state administrations and local self-government bodies. *Table 1 gives comparative analysis of objectives of the regional development policy and its expected implications. Orientation of this policy towards concrete results will ensure its effectiveness.*

Efficient realization of the state policy of regional development provides for **effective functioning of regional development institutions** founded with due regard to new economic conditions; **establishment of feedback and constructive dialogue with regions; elaboration of methodologies and procedures enabling national authorities to encourage and support regional initiatives in the field of social and economic restructuring**. Unfortunately, there are a lot of problems.

In the institutional aspect, there are only vertical state ties, whereas bodies of local self-government, public organizations and other institutions, such as regional think tanks, analytical and business centers are still not active. Indirect relations between the Ukrainian regions and the government as the major subject of the state policy of regional development are maintained only through regional state administrations mostly oriented towards implementation of instructions of the presidential administration. Influence of government agencies on state-owned enterprises is constantly decreasing due to privatization processes. In other words, **direct administrative impact on regional development has ceased to exist, whereas a new market-oriented system has not been formed yet**.

Non-compliance of statistical indicator system formed under the Soviet Union to requirements of analysis of contemporary economic processes **does not ensure even general monitoring, to say nothing of comprehensive everyday monitoring, short- and medium-term forecasting**.

However, the most serious hindrance to further transformations is, that in general, **available information, intellectual and organizational resources of national executive authorities do not correspond to scales and complexity of social reorganization in regions**.

As implementation of the state policy of regional development mostly depends on Ukraine’s government, I would like to pay close attention to proposals relating to strategies of governmental activities in 2002.

I deem that governmental activities must be focused on the following:

**Elaborate and introduce, at the national and regional levels, a system of regional development institutions controlled by the government.**

*Figure 1 gives a possible version of a structural scheme of institutional support for regional development.* The proposed scheme will be efficient provided that the government is able to ensure attraction of additional financial resources through national and local funds for programs and projects of regional development (see figure 2).

*Functioning of those funds should be based on the following principles:*

- Joint responsibility of all institutions participating in regional development for ultimate results
- Elimination of monopoly of some structures and administrative dictate of local authorities
- Introduction of concerted actions of all participants in the regional development processes and mutually beneficial agreements between them
- Orientation towards use of different sources for funding regional development

Activities of national and local funds are based on the principle of equal participation of authorities at a variety of levels in funding regional development programs and projects and responsibility of each participant for ultimate results. Hence, **the state** bears responsibility for financial resources and guarantees, while **a region** is responsible for consistency and social orientation of projects and **a city/town** assumes responsibility for financial support and realization of programs. Each participant shall allocate some funds for implementation of a project.

**Mastering and effective use of technologies, government support for regional development initiatives through a series of experiments aimed at elaboration of mechanisms ensuring social and economic transformations in Ukrainian regions and effective use of their internal economic potential.**

The essence of the above proposal is to ensure individual approach of regions to the issue of reforms by means of pilot project technology in the form of experiments in the public governance and legal spheres constantly monitored and controlled by the government. The most successful examples should serve as a basis for adoption of respective legal documents (see table 2). *Analogous proposals can be made apropos of other directions of development.*

Table 3 gives political and legal documents that would encourage introduction of the proposed strategy by the government.

Implementation of the above proposals will allow to:

- ☒ Provide a variety of concrete examples of social and economic transformations, which is necessary to ensure authenticity of general definitions in the process of forming legal basis of reforms
- ☒ Establish an effective system of instruments of government influence on social and economic situation in regions
- ☒ Work out a procedure for and methodology of feedback between national and regional authorities
- ☒ Establish the so-called zones of economic growth demonstrating positive results and setting new cultural standards of managerial and social relations
- ☒ Form, in the process of joint realization of projects, managerial personnel adequate to contemporary requirements and capable of disseminating advanced managerial methods all over Ukraine

In my viewpoint, should the government put the above proposals into effect, it will offer a powerful incentive to stabilization as well as further social and economic development of regions.



**Table 1.** Comparative Analysis of Objectives of the Regional Development Policy and Its Expected Implications

Objectives of the State Policy of Regional Development	Expected Implications
<b>1. Restructure regional economies on the innovation basis, thereby forming their new technological status</b> <b>Introduce mechanisms for rational use of internal economic potential of each individual region</b> <b>Support depressed territories</b> <b>Bridge a gap between economic and social development of regions</b>	<b>Emergence of new zones of economic growth that would conduct and new culture of managerial and social relations</b> <b>Dynamic development of competitive industries adequate division of labor, capital, goods and services</b> <b>Development of regional financial and communication</b> <b>Development of the labor market</b> <b>Selection of ruling elite, whose representatives possess</b> <b>Alleviation of social tension</b> <b>Reduction of discrepancies between social and economic</b> <b>Close inter-regional and trans-regional relations</b> <b>Promotion of regional economic integration</b>
<b>2. Improve financial and inter-budget relations between national and regional authorities, increase revenues of local budgets</b> <b>Complete formation of property of territorial communities</b>	<b>Decrease of budget expenditures</b> <b>Enhanced role of local taxes, duties and other mandatory</b> <b>Introduction of long-term budget planning</b> <b>Efficient system for financial regulation of regional development</b> <b>Availability of regional investment resources</b> <b>Formation of regional markets for real estate</b> <b>More active role of the secondary market for securities</b>
<b>3. Decentralize functions of executive power, delegate a significant part of authorities to regions Segregate and balance powers between national and regional authorities and bodies of local self-government</b> <b>Work out an effective mechanism for control over implementation of powers delegated to regional authorities and bodies of local self-government</b>	<b>Transparent, efficient and competitive system of local settlement of everyday economic problems</b>

**Table 2. Essence of Various Options of Experiments in the Public Governance and Legal Spheres for the Purpose of Supporting Regional Initiatives and Elaborating Mechanisms Ensuring Social and Economic Transformations in Regions and Effective Use of Their Internal Economic Potential**

Goals of the state policy of regional development	Essence of experiments in the public governance and legal spheres
Restructure regional economies on the innovation basis, thereby forming their new technological status Introduce mechanisms for rational use of internal economic potential of each individual region	Work out models for development of cities/towns (11 models) Work out new models for regional economic structures (associated, corporate, holding) and a special procedure for establishment of regional economic development associations Form infrastructure of regional development (think tanks, centers for political analysis and entrepreneurship support, regional development agencies etc.) Elaborate mechanisms for forecasting and strategic planning of regional development Work out methods for local support to small and medium business Elaborate mechanisms for improving quality of social and communal services Develop mechanisms for implementation of the land reform, specialization of regional and inter-regional exchange transactions Introduce efficient systems of regional management (regional development management) Establish trans-regional cooperation Form a state system of insurance against risks and implementation of regional development programs

	through foundation of a specialized insurance company Others
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**Table 3. Proposals Relating to Political and Legal Documents of the Government That Should Regulate Regional Development Policy in 2002**

<b>Name of the document</b>	<b>Type of the document</b>
“On Creation of a Task Force Dealing with Experiments in the Public Governance and Legal Spheres for the Purpose of Elaborating Mechanisms for Social and Economic Transformations in Regions”.	The Cabinet instruction
“On the Concept of Experiments in the Public Governance and Legal Spheres for the Purpose of Elaborating Mechanisms for Social and Economic Transformations in Regions and Effective Use of Regional Potential”	The Cabinet resolution
“On Experiments in the Public Governance and Legal Spheres for the Purpose of Elaborating Mechanisms for Social and Economic Transformations in Regional Development”	The Cabinet resolution
“On Means of Financial Support for Experiments in the Public Governance and Legal Spheres for the Purpose of Elaborating Mechanisms for Social and Economic Transformations in Regions”	The Cabinet resolution
“On Formation of Regional Development Institutions (State Institutional Support)”	The Cabinet resolution
“On Methodology for Assessment of Activities of Local State Administrations Relating to Implementation of Government Programs”	The Cabinet resolution
“On Monitoring Social and Economic Situation in Regions”	The Cabinet resolution

Figure 1. Structural Scheme of Institutional Support for Regional Development

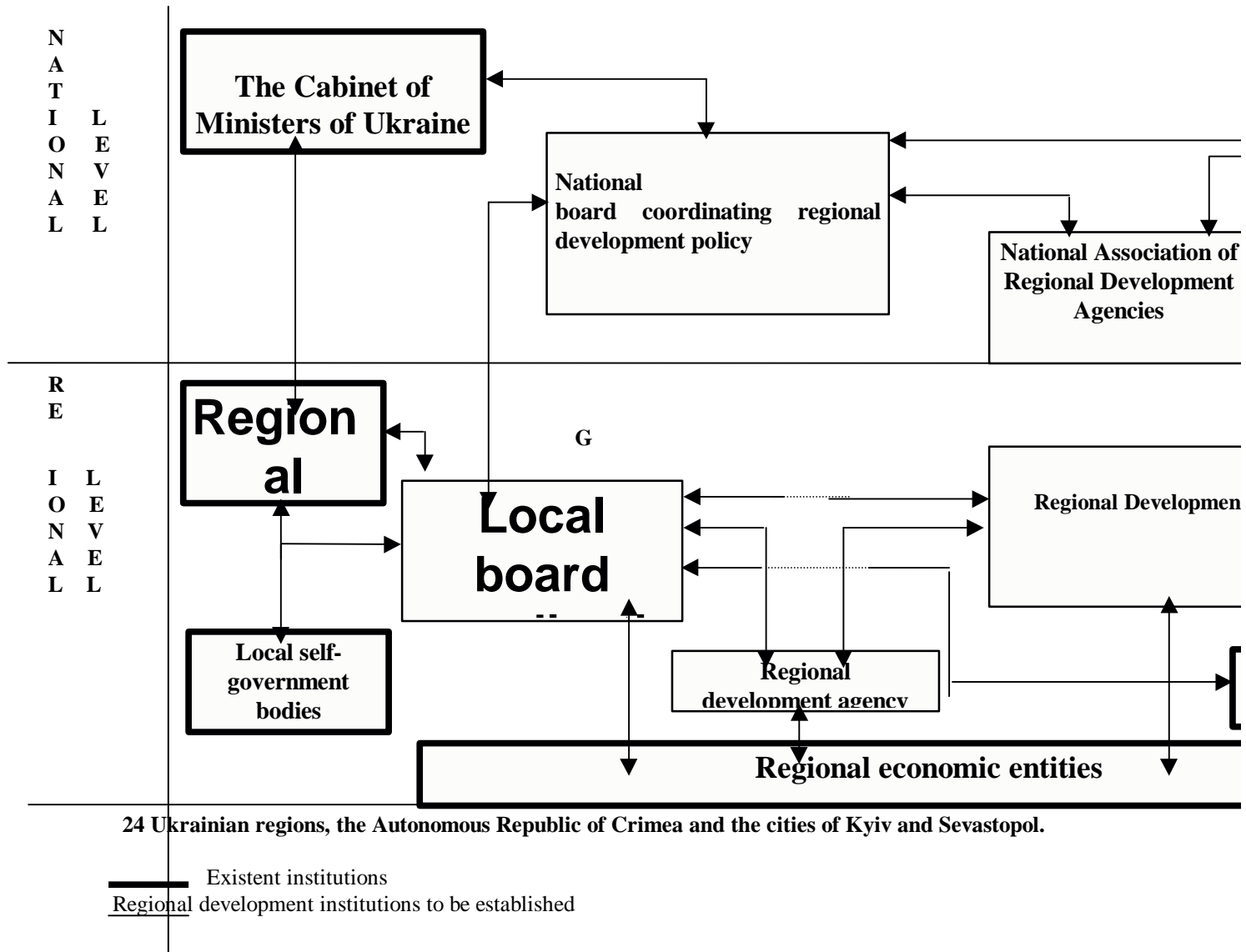
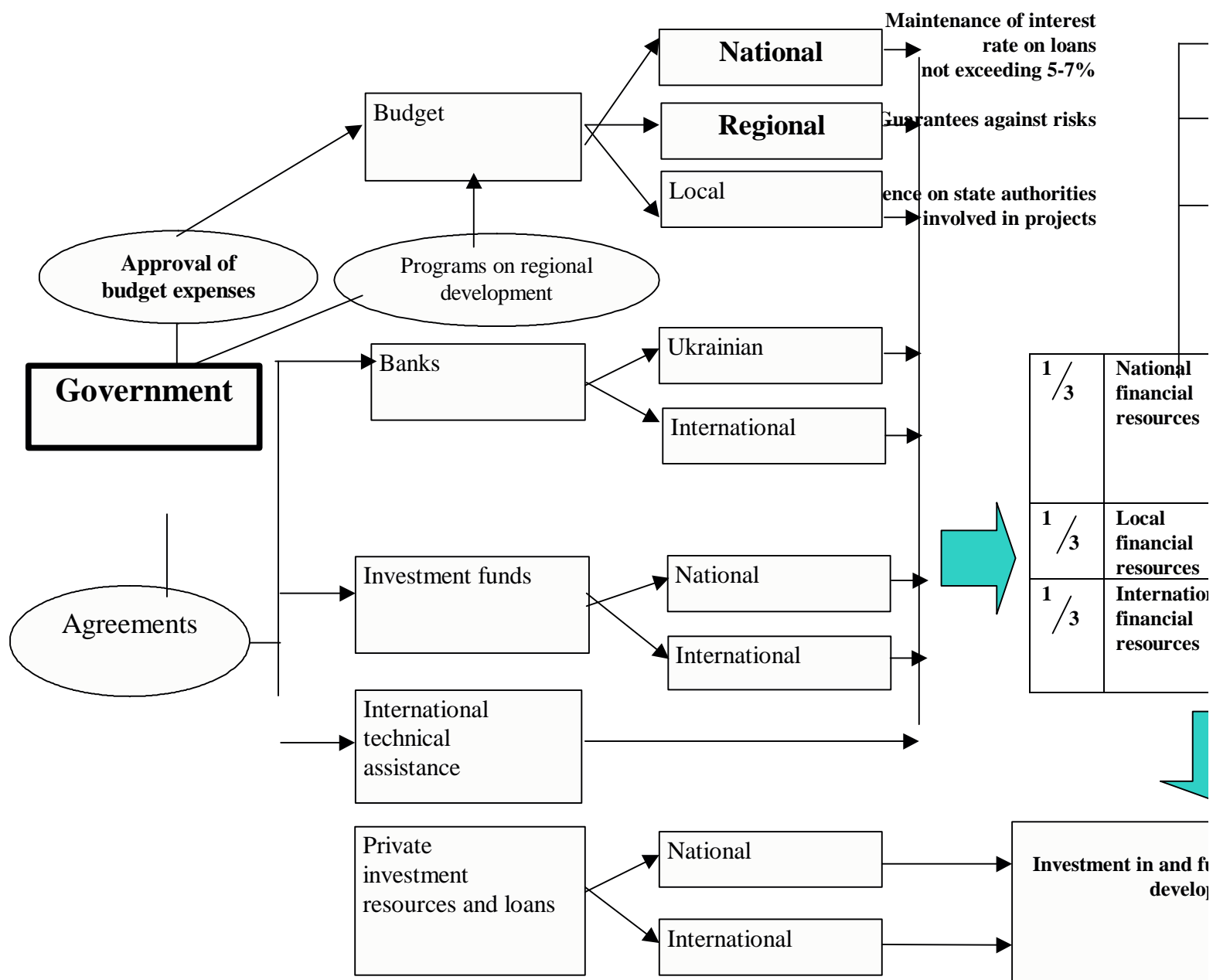


Figure 2. Scheme of Attraction and Use of Financial Resources Allocated for Regional Development



## **Transformation of Public Governance at the Current Stage of Social Development**

**Serhiy Maslichenko**

**Serhiy Maslichenko** - graduate student at the Chair of Political Economy at the Kyiv National University of Economics

Nowadays, the issue of the economic role of the state is of paramount importance. The future of our country strongly depends on its solution. Settlement of this problem will also determine efficiency of economic reforms and transformations, ability of Ukraine to find the way out of the economic crisis and to form a contemporary economic system that would ensure dynamic and effective development of the national economy and increase of living standards of Ukrainian citizens in the near future.

In the process of discussion and settlement of this issue, it is necessary to take into account all distinctions of Ukraine, its traditions and the current situation. However, first and foremost, it would be expedient to pay attention to general trends in world development and formation of a new civilization essentially altering the role of the state.

Economists-theorists have been dealing with the problem of the role of the state for over three centuries since the moment of formation of industrial society in the late seventeenth century, when the state started transforming into an active participant in economic activities. Since those times, different, even frequently opposite, viewpoints on this problem have dominated in society. Though, it is possible to distinguish two major tendencies discussed over the last 50 years: neoliberalism and institutionalism.

In 1930s, after the Great Depression, the whole world recognized the lack of vitality of the “laissez faire” doctrine in the circumstances of rapid development of production forces, high level of concentration of production and complicated economic ties. The above made economists deal with theories of public governance and understand the fact that contemporary economies represent mixed systems (or “contemporary” or “organized capitalism”, according to other scientists). The state played an enormous role in the Keynesian economic transformation of western countries and became one of the major participants of the market economy, having assumed a number of key social functions. Social and cultural achievements of the Keynesian economics paved the way for further technological, structural and informational revolutions.

Neoconservative revolutions of the last 25 years of this century substituted the Keynesian economics and initiated introduction of a new neoclassic doctrine. Under the neoclassic theory, the state became partially free from excessive functions of social security and redistribution. Its key function was no longer regarded as overall social protection of its citizens but was viewed as either unnecessary interference with economic activities or instrument of fight of influential political forces for their personal interest. Advocates of this theory believe a basic motive to any activity (economic or social) to be maximization of personal financial interests of an economic entity. According to the neoclassic theory, politics is viewed as a legal method for state interference with market mechanisms.

At the same time, it is impossible only to condemn the neoliberal approach to the role of the state in today's economy. On the one hand, neoliberals criticized a technocratic view on the state's role supported by adherents to the theory of welfare economics in 50-60s and again drew attention to a decisive role of politics in economy (though, they tried to lessen it). On the other hand, what is more important, their political and economic debates highlighted the problem of institutional aspects of economic life. Hence, alongside with the institutional trend, even the strongest advocates of the neoliberal doctrine recognized the magnitude of institutional factors in the role of the state. The most illustrative examples of such an approach are the North's work “History of Economic Thought” (1994) and the survey of the World Bank “The State in the World of Changes” (1999).

Therefore, I would like to more closely study institutional aspects of public regulation, which also relates to growing understanding of the fundamental role of spiritual, cultural, ideological and political factors in transformational processes.

Nowadays, many Ukrainian experts recognize importance of the institutional approach in social and economic transformations, since it makes possible to:

- Objectively assess ideology, strategy and practice of Ukrainian reforms

- Identify and analyze the number of economic entities, which will influence on enhancement and further development of the role of the Ukrainian state, civil society and civilized market



Raise question about correlation between market reforms and economic, legal and organizational framework associated with the institutional basis and infrastructure of market transformations

The new approach requires consideration of the problem of economic entities in the context of institutional transformations. In this respect, there are the following three major pillars: jural state, civil society and the market economy.

Being one of the strongest institutions, the state plays an important role in regulation of national economic systems at the end of 20<sup>th</sup> century, especially in developing states. The latter serve as a classic example of powerful impact of state institutions on economic reforms. Modern western theories appeared to be unable to predict rapid economic development of East Asian countries, for it was impossible even to imagine that institutional transformations in society would so strongly affect the system of economic interests of the private sector, pave the way for dynamic economic growth and that bureaucratic mechanisms would effectively govern and control those processes.

Experience of reforming the post-socialist economy proves strategic importance of the institutional aspect of transformation and its dominant role in economic policy. Having destroyed, within a relatively short period of time, institutions that ensured certain production, financial and social stability in society, reformers failed to quickly form a framework of the market economy, i.e. numerous institutions and agencies not existing under the former USSR, that would guarantee stability of the system at both the macro- and micro-levels. An unbridgeable gap between economic and institutional reforms could not but attract attention to the issue of establishment of market institutions in transitional economies.

In the process of formation of the contemporary market economy, foundation of institutes of private property and capital, development of the private business sector and entrepreneurs as major economic participants are imperative. From the viewpoint of general trends in social progress, development of the private business, corporate economy, large and giant financial and industrial groups and adequate organizational and managerial mechanisms are of the same importance.

Numerous mistakes in carrying out of market reforms can be explained by underestimation of the role of the state in formation and protection of market institutions. Analysis indicates that this factor is a determinant of successes and drawbacks of any transitional economy. Unlike at the initial stage of transformation, at present, tempo and consistency of definite economic reforms turned out to be not so important compared to rebuilding of the institutional system. Concrete actions of the state depend upon its national distinctions and economic situation within each period of time. Nevertheless, the state is responsible for the key prerequisites of the transitional period, i.e. not to admit disintegration and decline of institutes and ensure a “mild” change in the institutional system preventing conflicts between old and newly emerged structures.

Today, we witness the consistent process of formation of new significant economic subjects, i.e. civil society institutions, which start to more actively regulate economic and social processes. Those structures are represented by different agreements, conferences, associations, leagues of industrialists and entrepreneurs, associations of bankers as well as Chambers of Commerce and Industry and pertain to neither state agencies nor market economy institutions. They also include trade unions, social partnership institutions, consumer partnerships and ecological movements. All those structures are active participants and subjects regulating economic and social processes.

As for modification of the state’s function in realistic everyday life, the matter in question is delegation of powers of public governance not to the market but to civil society institutions being components of market mechanisms.

As a rule, the role of the state in economy is associated with deficiency or drawbacks of the market, which it must compensate. Should the market be perfect, public regulation will be useless. The more perfect is the market (80, 90, 95%), the less is the role of the state. Consequently, the market is necessary to compensate deficiency and drawbacks of state regulation.

In my opinion, such understanding of the role of the state is mistaken. Firstly, there is always a temptation to work out an ideal market model. Hence, approaching it, we will have to gradually reduce scales of state interference to the marginal.

Secondly, there are controversial viewpoints on superiority of the marker or the state. Most economists, especially those supporting the neoliberal theory, assert that the market preceded the state, whereas state institutions appeared as a result of deficient and imperfect market. One of the most striking examples of such vision is the social

agreement concept explaining formation of the state by a social agreement. From this standpoint, the state emerged to solve a common problem – to establish the law and order necessary for functioning of the market. Advocates of the institutionalisms theory guess that such comprehension of the state's role runs contrary to historical development of many countries and is an ideological protection of unfair market system. The point is that, in their opinion, the state preceded the market. History proves that except for the local (provision with essential commodities) and international (trade in valuables) levels of economy, till recently, market mechanism did not serve as an important ingredient of economic life. The statement of J. Stiglitz, outstanding neoclassic economist, of natural development of markets leaves us with an assumption that their formation almost always is initiated by the state, especially at initial stages of capitalistic development. For instance, in Great Britain, whose economic system is viewed as an example of pure market economy, state regulation played the decisive role in formation of market relations. The most complicated objective of early stages of industrial development of this country was to accommodate free market (or “simple and natural freedom”, according to A. Smith) to social needs. Difficulties related to establishment of legislation and order required bureaucratic control on the part of national authorities. The same is true about the United States of America. State interference with property rights, provision of primary infrastructure (first of all, railway transport and telegraph communications) and funding of agricultural research became of paramount importance for development of market relations at early stages of industrialization. In general, there is no advanced economy, where state institutions do not play active role in regulation of economic processes.

The point is that forms, methods and mechanisms of public regulation have been changing throughout historical development and have their distinctions in each individual state. The post-war industrial policy of France, encouragement of scientific research at early stages of Sweden's development, transformation of the private sector in Austria and rapid economic growth of East Asian countries proved the imperative and decisive role of the state in formation of those economies.

So, we cannot consider the role of the state as only compensatory and targeted toward elimination of market drawbacks. I deem that the situation looks much more complicated. There are some circumstances and factors, which represent exclusive prerogatives of the state.

In my opinion, the search for the answer to the above question “the state – the market” does not mirror a realistic social situation in principle and thereby is useless for both science and the decision-making process. On the whole, those categories can hardly be regarded as interrelated, for it is impossible to clearly distinguish public and market regulation.

In this respect, it would not be expedient to unambiguously interpret the role of the state, for instance, look for correlation between scales of state activities and the share of state-owned property or that of the GDP distributed through the national budget or volumes of state orders or contracts. No doubt that the afore-mentioned factors are very important but the mechanism for state regulation is more sophisticated, complicated and multi-faceted. Very often, its regulatory role can appear to be greater, while economic indicators, say, the share of property or the GDP distributed through the national budget, are relatively lower.

The above can be illustrated by examples of East Asian countries, Korea and Taiwan. Should we study the afore-mentioned indicators, we will find out that till recently, those countries were defined as those with minimal state influence on their economies (the World Development report of the World Bank, 1991 (In 1985, the share of public expenses amounted to 33% in the Japanese GDP, which was considerably smaller than in other industrial countries (47% - in Germany, 48% - in Great Britain, 52% - in France, 65% - in Sweden). In 1989, the share of expenditures of the Korean government reached the level of 16.9% or was much lower compared to other semi-industrial countries (21.2% - in Mexico, 30.6% - in Brazil, 32.5% - in Chile, 33% - in South Africa). In Taiwan, the situation is the identical.). However, it is incorrect. Mechanisms of realistic state influence on economic processes in those countries are different and therefore cannot be described by traditional statistical indicators.

According to the traditional theory of economics, the state performs its regulatory functions mostly through the mechanism for property in production means (which is mistakenly associated with their use) and redistribution of resources through taxes and subsidies, which is described, for instance, in the welfare economics conception. However, in East Asian countries, public regulation is exercised to lesser extent through the state-owned property or the budget system and mostly by means of mechanisms that do not require state property in production means or redistribution of resources and provide for the following:

- 1) Regulation of the process of entry into a market, its scales, pricing policy, technologies etc.
- 2) State influence on managerial decisions of banks about funding economy (especially, in Korea and Taiwan, where the majority of banking institutions are owned by the state)
- 3) A total of various informal channels for influence on the private sector (the so-called built-in instruments)

Hence, it is possible to state that in the process of determining scales of state regulation by means of statistical indicators, a total of institutional aspects is not paid attention to at all.

The above can also be explained by the fact that society is not just atomistic crowd of individuals and economic entities but has a rather sophisticated structure. Its structure is relatively complex and is characterized by a lasting process of more intensive socialization of a large number of individuals and economic entities forming different communities, strata, classes and other social groups according to their interests. So, it is not easy to keep the balance of those interests.

Research of the processes occurring in contemporary society helps us to understand that there are certain national or state interests being superior to personal ones. Those national interests represent not only an object of relations between countries but also a motive determining behavior, life and political course of each country. Should it be the case, we must also re-comprehend and re-assess the very nature, sources and goals of existence of the state that has to safeguard and protect general national interests.

In this aspect, it is necessary to pay closer attention to the role of the state at the international level and find its place under the circumstances of today's globalization. Should we analyze framework of the global economy, it will be possible to distinguish its three major pillars: national states and their unions, transnational capitals, multinational corporations and banks as their organizational and legal forms, and international economic institutes for regulation and coordination. Those pillars are closely interrelated and maintain intensive relations with each other, including those in the sphere of their personal interests.

States and their integration formations stimulate activities of multinationals, whose origin and location are important for national interests. Those states influence activities of multinationals as members of the International Monetary Fund, the World Bank, the World Trade Organization and other international economic institutions rendering comprehensive financial and economic assistance to western economies and their political systems and actively forming institutional basis of a new market economy.

Wildcat protests against contemporary globalization and its forms are stupid, since it is an objective process. Although, issues of identification of a basis for development of globalization, its relationship with ideas of a new multipolar world, interests of national states and individual regions still remain open. It is believed that business must meet challenges of globalization generating such phenomena as transnational capitals, world financial markets, multinational corporations and banks. However, given this situation, insufficient attention is paid to the fact that a national state founded on the ideas of national self-determination and world significance can also meet such challenges. So, in the above context, it is necessary to take into account the role of the state and multinationals in globalization.

Modern multinationals are characterized by relatively independent and important role in economic and political globalization. Multinationals and national states are compared by their potential and extent of impact. Though, there is a concern that a new world economy lays the foundations undermining the role of national states. As a rule, to combat those negative tendencies, it is proposed to form transnational political movements and institutions that have enough influence to impose confinements on power of multinational corporations, which is very important. However, we must also understand that consolidation and interaction of multinationals with a strong national state is a source of their power. Therefore, transnational political movements and institutions cannot function efficiently on their own and without support of national states, especially those, which are objects of expansion and exploitation for transnational capitals.

In view of principles of the globalization process, emergence of new world economic entities and geopolitics, new political forces and distinctions of their interaction and balance, it would be inexpedient to discuss inevitable weakening of the role of the state and restrict it to inexpensive and compact mechanism for control and supervision of compliance with general rules. New circumstances call for new realities forming new environment of functioning of national states. The state becomes the most powerful and responsible subject representing and safeguarding national interests before the only, for the time being, global state – the consolidated West and also the existent regional unions, associations and multinationals. The place of the state in a new world hierarchy, abilities to protect its political and economic sovereignty and influence national and international political processes depend on understanding of realities of a new world economy. It is especially acute for Ukraine in view of its specific geopolitical location and singularity of historical development. The Ukrainian state must become the major subject and guarantor of the national sovereignty, national interests and national development.

## Strategic Restructuring of Enterprises as the Way to Survive in the Market Economy

Anatoliy Stupnytsky

By Anatoliy **Stupnytsky** - expert in business planning and restructuring of industrial enterprises at the Vinnytsya Chamber of Commerce and Industry

Everyone is aware about negative consequences of the large-scale process of economic transformations that now is under way in Ukraine. Economic conditions, incentives and Ukraine's business environment have radically changed. Many Ukrainian enterprises could not efficiently operate and survive under new circumstances and most of them appeared on the verge of bankruptcy. Though, practice proves that large-scale restructuring of enterprises aimed at introduction of new approaches to establishment and further development of production and commercial ties is of paramount importance. In general, restructuring is based on systemic analysis and strategic planning.

Taking into account the world experience, it should be mentioned that restructuring is mostly designed for a company, whose profit is constantly decreasing, or an expanding enterprise that needs restructuring for strengthening its market position and increasing profit. In the situation, when a lot of time is wasted and the majority of Ukrainian enterprises either went bankrupts or found themselves on the verge of bankruptcy, restructuring is used as an emergency measure targeted, at least, towards implementation of a program on renewal of solvency of company-debtors. Such activity was initiated in 1997 by the Agency for Bankruptcy of Enterprises and involved 400 enterprises subordinate to nine ministries and state committees. Effectiveness of taken steps is confirmed by the following data: prior to restructuring plan, arrears of enterprises amounted to UAH 281,320.3 million and, officially, UAH 313,167.0 million, as of January 1, 1999. The above data demonstrate that it is impossible to achieve rapid positive changes. Restructuring of enterprises and companies is a very hard and exhausting work, which can bring either success or failure. Intention to do everything quickly and in a slipshod manner is by no means a way out.

Restructuring documents serve as an important analytical basis for planning of a medium- and long-term strategy of any company. However, it should be mentioned that restructuring couldn't save all companies being on the verge of bankruptcy. It is necessary to make all-out efforts so that to safeguard industrial potential of Ukraine. Restructuring of companies, whose ideology must be based on approaches generally accepted in the world, is not a philosophic doctrine but a frame of mind.

This article will closely study and analyze the problem of restructuring. Opinions and viewpoints stated below are nothing more than assumptions and the article is rather a discussion.

### Essence of the Restructuring Process

The classic notion of **structure** (formation, basis, framework) means a total of stable ties of object ensuring its integrity and preserving its basic distinctions under various external and internal changes. Therefore, **restructuring** can be viewed as a reverse process caused by objective factors. **Structural reconstruction** is a process of organizational, managerial, financial, technical and production accommodation of a production structure to constantly changing market conditions for the purpose of increasing its efficiency and competitiveness. Structural reconstruction implies evolutionary changes in business strategy and financial structure thereby ensuring stable competitive position in the market. Restructuring of enterprises should be regarded as a **temporary comprehensive problem**.

The process of financial and production restructuring can be divided into the following four essential stages:

- 1) Technical and economic analysis of production
- 2) Forecast of capacity of the commodity market
- 3) Proposals for rational use of available production potentials with due regard to the need for technological re-equipment
- 4) Attraction of capital to be allocated for technical and technological re-equipment of production

**Technical and economic analysis** of production provides for examination of specificity and distinctive features of production and financial activities of each individual enterprise and elaboration of definite measures geared toward optimal combination of up-to-date engineering and design innovations and available production capacities. In other words, this method is focused on optimization of the production process and reduction of production cycles, which will entail decrease of all types of production expenditures and improvement of financial indicators. In general, technical and economic analysis of production is nothing more than scientific organization of production process targeted towards introduction of advanced technologies.

Forecast of market capacity is based on marketing research on the following two key problems:

1. Whether we can sell products
2. Whether we will derive profit

Essence of **marketing analysis** is to collect and analyze this information and work out strategies on its basis. The most important questions for the sales market analyses are as follows: “Who are potential consumers of our products? What is potential capacity of the market for our commodities? Is there elastic demand for our goods? What are the best promotional measures: advertisement, exhibitions or special publications in periodicals?” The marketing analysis also provides for identification of key factors of success of commodities: quality, originality, attractiveness, safety, durability etc.

**Proposals for rational and effective use of available production potentials with due regard to the need for technological re-equipment** must meet the following requirements. Firstly, having analyzed compliance of deterioration of equipment with technical requirements, it is necessary to determine what facilities must be retained. Secondly, planning to substitute equipment with more technologically advanced, it is necessary to get aware about expenses for energy resources (electric, thermal power etc.), which will directly facilitate cutting of production costs. Thirdly, proceeding from industrial specificity and technological distinctions of an individual enterprise, it is expedient to use universal equipment, which can also ensure reorientation of enterprise to make marketable products. Hence, the above will contribute to formation of stages of flexible technological processes. Machine-building enterprises must pay special attention to that requirement. Fourthly, with due regard to non-payment crisis and a temporary decline in demand and production, proposals relating to specialized enterprises, such as those producing building structures and materials, bearings, foodstuffs and sugar refineries, must be focused on reconstruction of technological processes influencing quality of products and cutting production costs. In other words, it is necessary to apply a method for local technological re-equipment, which will allow saving substantial amount of capital investment within a definite period of time. Fifthly, forecast of market capacity calls for a rational and reasonable proportion between progressive equipment as well as technical and technological improvement of products that, for the time being, do not meet general requirements, which can be achieved during research and design stages.

On the other hand, attempts to produce high-grade goods using outdated or life-expired equipment will frequently produce no positive results. So, it would be advisable to keep to reasonable proportions. Sixthly, prior to making a decision on expansion/segmentation of an enterprise, it is necessary to make an in-depth motivational analysis and estimate reasons for possible actions. The latter can be of tactical, strategic, individual and psychological nature. Tactical, individual and psychological motivations will unlikely ensure comprehensive solution of an enterprise's problems. Therefore, possible expansion of enterprises should be based on strategic restructuring and change in paradigm of those processes, which implies a new vision of objective reasons that evoked those changes.

Among all factors that allow making the most optimal decision on expansion of an enterprise, it is possible to differentiate the following ones. Firstly, a reason for expansion is a possibility of further use of a large existent production potential. The above can be explained by a relatively low technological level of production, which does not enable an enterprise to make competitive goods, for their sales markets are saturated. In such a situation, restructuring is possible but it requires enormous amount of capital investments and long period of their recoupment, which does not attract investors. As a rule, capital investment in large enterprises are made when value of new products is expected to be much lower as compared to existing analogues or much higher according to its technological level thereby ensuring high competitiveness.

Secondly, expansion of enterprises can be efficient only in the event that there is an opportunity to manufacture necessary products making minimal capital expenses within a relatively short period of time, which requires modernization of production process, inclusive of finished technological cycle.

Thirdly, in the process of expansion forecast, it is necessary to determine a rational proportion between value of assets and liabilities of basic production funds, since it will inevitably affect potential production costs. There is an opinion that small enterprises are more mobile in competitive environment, can be quicker re-oriented to manufacture sought after commodities and are easier to manage. This viewpoint is correct in principle. However, as for actual impact on market situation, an individual small enterprise does not possess realistic and strong economic tools. For this reason, activities of small enterprises appeared to be more efficient, if they are members of financial and industrial groups (vertical or horizontal) or invest venture capital in their own companies, which enable them to apply advanced technologies different from those in other industries.

### **Problems to Be Resolved during the Restructuring Process**



**Maximization of stockholders' wealth** in the form of higher dividends and due to increase of market value of shares is a key function and responsibility of managers. Measures fostering maximization of share value are beneficial for society on the whole. The goal of maximization of share value calls for development of commodities and services consumers will be interested to buy. Hence, intention to derive profit should stimulate creation of new scientific innovations, mastering of new technologies, manufacture of new goods, creation of new jobs etc.

**Social responsibility** means that social measures and arrangements require expenses. It is necessary to determine which share of those expenditures companies will voluntarily assume and which one will be imposed on them by virtue of law. Any voluntary social expenses increasing cost of products are impossible in industries, where severe competition dominates. All the above aspects should be described in the national legislation.

**Duties and responsibilities of managers** imply that except for maximization of share value, they must grant privileges to their employees, increase salaries and participate in public advocacy.

**Factors that make managers to serve stockholders' interests** include concentration of a relatively large share of property in hands of other stockholders, dependence of a manager's remuneration on dividend on shares, a threat of re-purchase of a company by other organization (the so-called raider) or dismissal and competition for a position of manager.

**Risks in the restructuring process** appear to be higher for directors and managers than for stockholders. The latter can insure those risks, for they possess a diversified portfolio of securities.

**Remuneration** of a manager, especially his stimulation, must depend on stockholder dividends. Remuneration programs must not be aimed exclusively at top managers but should also stimulate managers at a variety of levels.

**Insecurity relating to re-purchase of companies** can emerge, when managers act in their personal interests and to the detriment of shareholder interests. Low face value of shares is attractive for re-purchase of a company.

**Raiders/conquerors** look for ineffectively managed promising companies, where drastic changes in strategy can entail substantial increase of understated value of shares in the assets and securities markets. The above is identified with internal value of company.

**Labor market** is an important motivational mechanism for managers' conduct. Managers compete for their positions with both other employees of a company and outsider candidates. In the frameworks of an individual company, key mechanisms controlling results of activities and performance of managerial personnel are represented by assessments of those results and compliance with programs on remuneration and stimulation of managers.

**Drastic economic changes, restructuring and transformations in the world financial markets** engender weakening of financial regulation, development of information technologies, emergence of new financial instruments, macroeconomic imbalance and high interests rate.

**Accelerated process of technological development** requires reduction of living cycle of commodities, rebuilding of production processes, development of new products and services and alteration of inter-branch relations.

**Distinctions of contemporary business** are characterized by its complex and constantly changing nature, lack of time for making decisions and global competition. As for this changing world, sizes or profit of companies are meaningless. A company must either accommodate to changes or collapse. Global competition sets requirements to survival of enterprises. To survive, a company has to dominate in the market. Radical changes in external environment call for changes in ideology.

**Privatization** should be geared toward formation and accumulation of effective capital, which directly depends on restructuring. Industrial restructuring puts forward measures for overcoming the gap between current results of an enterprise's activities and requirements of international competition. This gap is a result of global changes in macroeconomic and political environment, technologies, organizational frameworks, marketing approaches, production prices etc.

**Hence, restructuring is a steady and persistent process. Financial restructuring leads to liquidation of some enterprises (departments), assets written off the balance, reduction of expenditures, growing share of borrowed**

funds in the structure of capital and purchase of a company's own shares in the market. The major goal of financial reorganization is a change in capital framework.

**Business strategy is a very important factor.** It consists of the following pillars: investments in development, investments for maintenance of a company's position, milking policy, placement of resources according to the needs of production units and achievement of synergic effect. **Diversification strategy** is focused on improvement of products, purposes of its use and after-sale services. The ultimate goal is to make products of such quality and value that would absolutely differ from those of competitors and which they would not be able to quickly imitate. **Strategy of reduced expenses** implies withdrawal of all unnecessary expenses, use of cheap promotional channels and labor force, automation and introduction of innovations, purchase of inexpensive equipment and facilities and decrease of overhead expenses.

**Quantitative and qualitative criteria of assessment** usually relate to the market share, growth of sales volume, the amount of expenditures for efficiency of production and sales, fluctuation of personnel, ability to attract highly-qualified and well-trained managers, expansion of the number of services rendered to customers, profound knowledge of the market and reduction of threats and risks.

**Restructuring** creates difficult conditions for functioning of enterprises **during the transitional period.** Those conditions are characterized by a high level of uncertainty and macroeconomic instability, sharp changes in sales markets and competition requirements, absence and inconsistency of information, deficiency or non-compliance of the national legislation and procedural rules with market mechanisms, disappearance of usual communication channels and procedures and intensification of social conflicts. Those factors can result in lost of orientation and abnormal attitude to reality. All the above can spontaneously trigger a negative reaction to changes. Orientation to the past generates a feeling of the "lost good old times". On the contrary, orientation to the future leads to revaluation of personal conduct and positions and causes a desire to act under new circumstances. Attention paid to entourage helps to set new realistic goals and work for their realization.

**Financial analysis is yet another major factor of restructuring.** Financial position of an economic entity is characterized by its solvency, competitiveness, use of financial resources and capital, meeting of liabilities to the state and other economic entities. In the process of its financial analysis it is possible to determine dynamics of changes in profit, level of profitability and factors influencing it. Basic reasons affecting net profit include volumes of profit from sales, level of production costs and profitability, incomes from other activities and rate of the profit and other taxes. An economic entity that is able to repay assets (basic funds, intangibles, floating assets etc) at the expense of its own funds, avoid unjustified payables and receivables and timely pay its liabilities can be viewed as financially stable. Liquidity of an economic entity means its ability to quickly pay its debts and possess liquid assets to be used for settlement of debts (cash, deposits, securities, floating assets that can be sold etc). Hence, liquidity of an economic entity determines the state of its balance and solvency. What matters is to estimate financial opportunities and reach the level of predicted incomes, profits and financial flows.

**Business restructuring** offers more opportunities to use strategic products (reduction of prices, introduction period, risks for new products and innovations), whereas physical restructuring provides for revaluation and displacement of equipment and facilities; introduction of new advanced technological processes; development of production of new finished goods; penetration into new markets. The above calls for drastic changes in personal **business culture** of all parties concerned and adoption of such business culture that would ease cooperation with stakeholders and cultivate the sense of mutual participation and ownership. **Financial restructuring** means enhancement of short-term liquidity, i.e. improvement of the process of generation of financial resources; creation of heterogeneous capital framework adequate to strategic needs and perfection of methods for its use; improvement of quality of financial reports.

Financial analysis will provide companies and enterprises with correct formulation of both tactical and strategic goals and objectives, of which the most important one is restructuring of production and business. Within the period 1981-1988, 50% US companies collapsed because restructuring measures were not strategic and implemented at a large scale. In a tactical aspect, company managers must understand the need for restructuring, establish and maintain order in the spheres of production and trade. As for strategic aspect, they have to change their ideology. Otherwise, sooner or later, a company will inevitably collapse.

There is an opinion that foreign capital does not come in Ukraine's economy because of inadequacy of our legislation to legal protection of capital and onerous tax burden. As a matter of fact, those reasons cannot be disregarded though there are other numerous factors impeding the investment process. First and foremost, they include a deficient privatization procedure. As a result, companies are owned by Ukrainian investors, who, according to

estimates of foreign experts, legally own a relatively small amount of capital. They cannot ensure large-scale development of production and trade relations, which forms preconditions for long-term economic stagnation. Furthermore, due to crisis financial situation, the majority of companies do not meet requirements to the securities market: most enterprises are actually unable to follow the listing procedure and therefore cannot be quoted at stock exchange, for this market (initial, secondary, exchange and extra-exchange) remains underdeveloped.

Perhaps, the only possible method for attraction of both foreign and domestic capitals is direct investment in statutory funds of Ukrainian companies and enterprises. Investors are eager to provide financial resources and hold consultations on managerial issues and control company's management for protection of their investments, if needed. Hence, it is necessary to propose controlling stockholding to investment companies or individual investors. In the long run, such form of investment process will result in formation of strategic alliances.

The Vinnytsya region has just embarked on the way to restructuring. For the purpose of accelerating this process, the April 26, 2001 round table session "Aspects of strategic restructuring of enterprises" was held in the Vinnytsya Chamber of Commerce and Industry. During discussion it was emphasized that there was a dire need to launch a large-scale educational and advocacy campaign explaining strategy and tactics of restructuring of Ukrainian enterprises.

### **Conclusions**

Restructuring is a complicated and difficult process. It is not a quick work but evolutionary changes in tactics and strategy of companies' functioning.

Restructuring provides for elimination of drawbacks in legal policy, approaches to principles of economic and market transformations, identification of methods for improvement of market infrastructure aimed at enhancement of competitiveness, better migration of capital, creation of conditions for steady changes in property framework, increase of mobility of labor resources, better and closer control over financial flows and cultivation of skills and abilities in effective management of companies.

Major ingredients of the restructuring process incorporate elimination of deeply-rooted reasons for deterioration of an enterprise's position; orientation towards absolutely new directions of activity with a strong accent on a confined number of key goals; short-term objectives in the frameworks of a long-term strategy; the need for preliminary training; systemic diagnostics of production and financial positions of enterprises/companies so that to clearly visualize the situation and determine strategic vitality (profound potential) of companies; detailed analysis of external and internal conditions; prediction of the market share of strategic products.

### **Formation of Ukraine's Model of the Social Market Economy**

Vladyslav **Anin**

By Vladyslav **Anin**, student of the Horlivka vocational school at the Donetsk National University

The All-Ukrainian Forum "Young Economy" took place in Kyiv on December 18, 2001. The contest of works on economic problems was announced among young economists in the frameworks of the Forum. The Forum was initiated by public organizations – the Institute for Reform and the League of Entrepreneurs "New Formation" in assistance of the Ministry of Economy of Ukraine.

About 300 young people before 30 from all Ukrainian regions participated in the Forum. The contests provided for four nominations: 1) schoolchildren of X-XI classes; 2) students of I-III courses of institutes and universities (I-IV accreditation grades); 3) students of IV-V courses of institutes and universities, post-graduate students, teachers and economists before 30 years; 4) student, post-graduate students and teachers of journalism faculties, representatives of the mass media before 30.

#### **Each nomination required writing of works on certain topics:**

##### **- the first nomination:**

*Why do I believe (disbelieve) Ukraine's economy to become efficient and successfully functioning in the near future?*

##### **- the second and third nominations:**

*If I were minister of economy, first of all, I would do ...*

*How to combat poverty in Ukraine?*

*How to make Ukraine major European grain supplier?*  
*How to form a powerful middle class in Ukraine?*  
*Is it possible to make Ukraine really attractive for tourists?*  
*Does Ukraine need the public sector of economy?*  
*What does Ukraine need: strong hryvnya or strong dollar?*  
*How to form a social market economy model in Ukraine?*  
*How to make national intellectual potential work for Ukraine's economy?*

**- the fourth nomination:**

*Journalist research on resonance economic phenomena (at author's discretion).*

We propose you to get familiarized with a work of Vladyslav Anin, student of the Horlivka vocational school at the Donetsk National University, who got the second and the third nominations. His article is dedicated to formation of a social market economy model in Ukraine.

## **Introduction**

It is strategically important to form Ukraine's model of the social market economy so that to work out, introduce and further develop an efficient mechanism regulating the national economy.

After all, everyone should know what he/she wants. So, state authorities must clearly understand their intentions to efficiently carry out all reforms and transformations. Should we solve the above problem, we will be able to correctly identify the essence and guidelines of the reforming process in Ukraine.

Why has the Ukrainian government declared the course towards **the social market economy**?

Before answering this question, it is necessary to mention that, due to a number of reasons, socially-oriented market economy has played the role of a new economic paradigm since 1960s.

Many western experts believe the social market economy to be the so-called transition from capitalism to socialism guaranteeing freedom and social equality<sup>1</sup>. Combination of the market and planned economy or centralized economic system serves as an important criterion of the social market economy<sup>2</sup>.

In general, the need for state interference with economic activities is caused by numerous reasons. However, Ukraine's distinctions provide for absolute impossibility of formation and functioning of the national market as a self-sufficient and self-regulating system. Hence, market regulation is really inevitable.

The first and the most important reason is represented by abortive attempts of Ukrainian economists to substantiate the necessity for rapid introduction of mechanisms for market self-regulation in the situation, when almost all property was owned by the state.

The situation, when exclusively state-owned enterprises-monopolists were offered to follow market rules being far from optimal, produced results absolutely different from those in civilized market economies. As monopolies got their hands on instruments of the price liberalization policy, it engendered price chaos, stagnation, an unbridgeable gap between incomes of different social groups etc.

In other words, an attempt to rapidly substitute the system of centralized planning as a major method for managing the public sector with market mechanisms appeared to be nothing more than a "shady enterprise and a sheer nonsense". State-owned enterprises, of which every second could be viewed as a monopolist, took advantage of freedom of market relations and absence of adequate market regulation thereby deriving additional benefits. Having established commercial structures, state monopolists used them for export of essential commodities and transfer of giant capitals to foreign banks.

The above brings us to a conclusion that monopoly of state-owned property and market self-regulation are totally incompatible. Ignorance of this fact can result in economic chaos. Therefore, it is necessary to introduce a system for economic and administrative market regulation in Ukraine.

Another reason for the need to introduce such regulation is the fact that Ukrainian enterprises proved to be unable to produce finished goods and could only conclude contracts for manufacture of semi-finished products. Given this situation, all efforts to introduce market regulatory mechanisms and apply market regulatory principles in relations with suppliers of raw materials and manufactures threaten with both internal and foreign economic collapse. Attempts to operated in the market better than those, who adhered to basic market principles for hundreds of years,

and total neglect of market regulation evoked social and economic disproportions, which can discredit the idea of transition from the command to market economy in the eyes of many people. Intentions to introduce market regulatory mechanisms in the post-Soviet economy based on anti-market principles appeared to be mistaken. Hence, we have to make the following conclusion: Ukraine's pseudo market economy needs more regulation as compared to any developed market economic system.

Yet another reason for failure of those attempts logically ensues from the previous one, since the need for market regulation is caused by inevitable decrease of Ukraine's foreign trade turnover with the CIS and East European countries. Moreover, the country's internal economic ties are still inefficient, which also makes management of economy using exclusively market instruments impossible. Five or six years ago, within the period of transition from the totalitarian regime to new market relations, we could harbor hopes. However, for the time being, there are no grounds to view functioning of market mechanisms as something that goes without saying.

It is common knowledge that as there is the need to institute social protection measures geared toward maintenance of adequate living standards, i.e. unemployment allowances, price indexing and consumer protection, the market economy can evoke such negative phenomena as unemployment, price rise and others but, at present, there is no other alternative. Socially oriented market economy is the most efficient compared to other systems. For the time being, mankind invented nothing better. Consequently, social development is possible only under market economic conditions.

### **Essence of the Social Market Economy Model**

In the process of historic development, market economy experienced drastic changes. For instance, the theoretical conception of the Social Market Economy, developed by German economists L. Erhard and W. Eucken, considerably differs from the classic theory of liberal or market economy. Social Market Economy means a mixture between a classical liberal way of thinking and social, state managed elements. Therefore, not only the economic aspects but, freedom and social justice were the major objectives of the Social Market Economy. L. Erhard and W. Eucken believed that it would be necessary to install social security mechanisms beside the market forces controlled by the state. Another aim of the Social Market Economy was to create and develop an economic order that could be accepted by any ideology so that all forces in society could be focused on the common task of ensuring the basic living standards and conditions and reconstruction of the economy. Hence, it is not the third way debate but an economic, social and political program. The theoretical conception of the Social Market Economy is based on the idea that liberal rights of individuals and the economic freedom can be seen as frame conditions, under which social justice and solidarity are implemented.

The often raised question whether it could work as an example for other countries in the transition to democracy or rebuilding can hardly be answered because of the special historical situation, in which the Social Market Economy had its greatest success<sup>3</sup>.

In his work "Economic Management and Market Economy" (1946), A. Muller-Armack identified criteria and attributes of the Social Market Economy and wrote that it aimed to balance the market and social principles<sup>4</sup>.

The above means introduction of such a mechanism for distribution of national income, which would provide for neither excessive prosperity nor poverty of citizens. Market mechanism for earning differentiated incomes must be balanced by means of appropriate allocation of the country's social expenditures and implementation of a sound taxation policy.

One of the major goals of the Social Market Economy is to create an adequate environment for efficient functioning of market mechanisms. This policy is targeted toward enactment of the law against hindrances to competition, having taken under close control activities of monopolies, oligopolies and cartels.

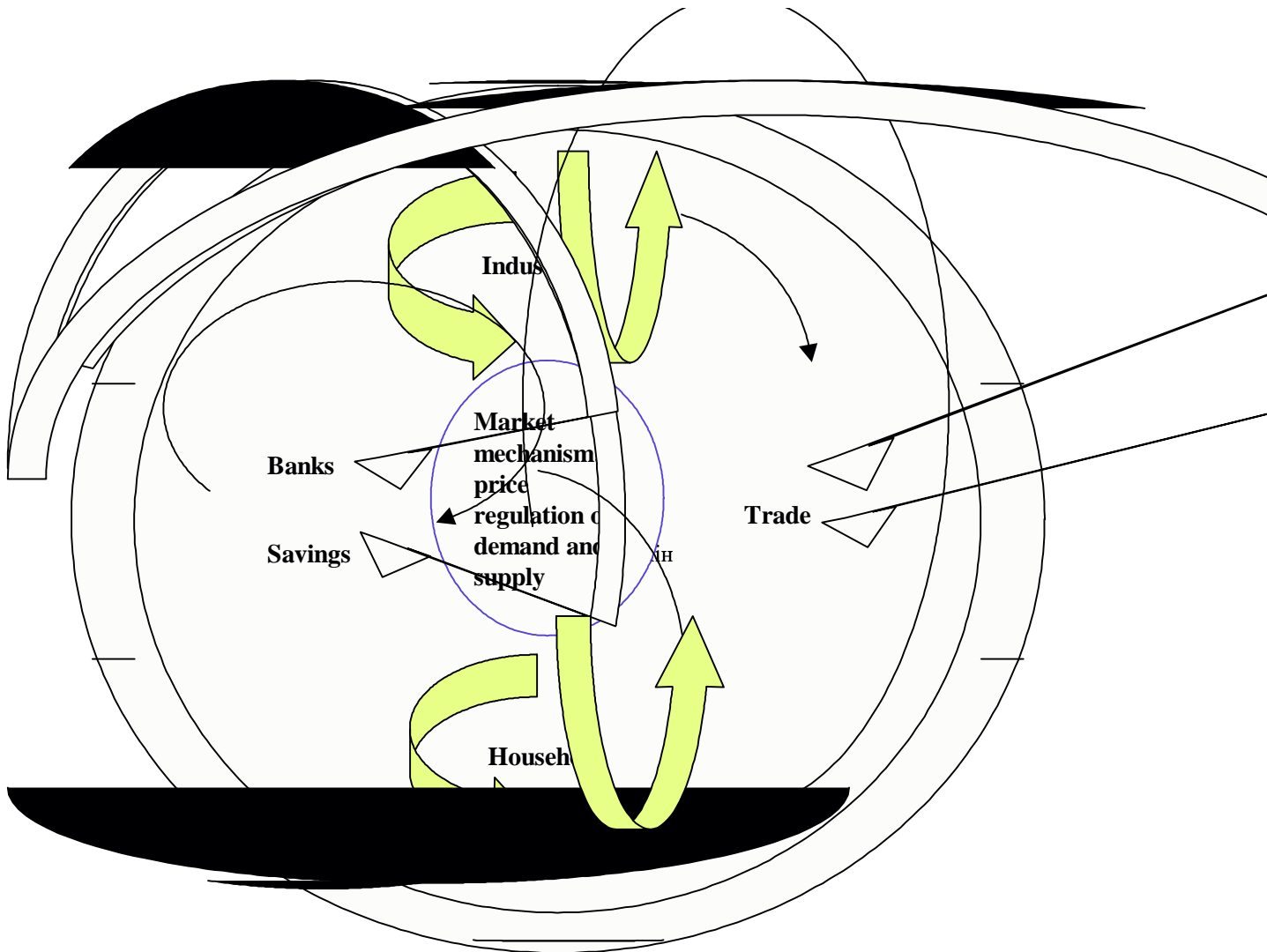
The most imperative measures should be fiscal, monetary, foreign economic and income policies. The German neoliberals clearly understood the magnitude of those steps.

In the opinion of L. Erhard, the Social Market Economy cannot exist without adherence to consistent and stable currency exchange policy, which can prevent enrichment of some social groups at the expense of the others.

Therefore, key integral parts of the Social Market Economy include:

- competition based on private property in means of production; the market coordinating and regulating economic activity; household, industrial, agricultural, banking, trade, transportation and other enterprises as economic entities
- the state, which due to the policy maintaining market competition and regulating its legal basis, exercises control over general rules of the market economy





The state will foster social leveling using such regulatory instruments as fiscal system, taxation policy, regulation of... Social Market... the circumstances... demonstrated their... regulation. Though, economic... activities<sup>6</sup>. In practice, market... market economy cannot survive... revive economy of free competition... aspect, famous economist J. Galbraith states... mistaken that their intentions can be regarded as... to survive and exist in western countries because of the government regulation.

Deliberating over the need for macro-economic planning, outstanding American businessman and manager L. Jacock emphasizes that public regulation does not mean socialism but clearly-formulated and well-reasoned strategy and goals.

Regulation implies sound coordination of all aspects of economic policy in lieu of their partial implementation... Should we fail to reject once and forever an absurd idea that state planning and capitalism are completely incompatible, we will never reach any success<sup>8</sup>.

### World Experience of Formation of the Socially-Oriented Market Systems

There are numerous subjective and objective factors influencing formation of the future economic model of Ukraine. Post-Soviet nature of our economy inherited from the former USSR is an important but not the only factor

determining the essence of that model. Each of economic mechanisms known for today is inappropriate for Ukraine's national economy. At the same time, it is difficult to imagine Ukraine's market absolutely different from any existent in the world. I would like to discuss the most famous ones.

The "Japanese model" is characterized by a definite gap between living standards of population, including wages and salaries, and increasing level of labor productivity. For the above reason, production costs are low, which enhances competitiveness of Japanese commodities on the world market. For the purpose of encouraging entrepreneurship, Japanese authorities exercise no strict public control over stratification of population's incomes. The "Japanese model of market economy" provides for institution of administrative and economic regulatory measures, i.e. in case of certain corporations, the government establishes a clearly-defined period for renewal of equipment and punitive sanctions for non-compliance or makes decisions to shut down some enterprises etc <sup>9</sup>. However, efficiency of this model is possible only subject to highly developed civil consciousness, when society recognizes priority of national interests over those individual.

The "Swedish model" differs in strong social policy aimed at elimination of property and social inequality due to redistribution of the national income in favor of the most impoverished citizens. The above creates favorable conditions for renewal of highly-qualified manpower in both industrial and services sectors.

As compared to the United States of America, the share of funds to be earmarked for re-training of workers and employees is higher than that assigned for unemployment benefits.

In contrast to Great Britain, employment of population is maintained rather by re-training of workers and employees than retention of jobs. The social security policy ensures high level of satisfaction of social needs through redistribution of taxes and other mandatory payments (rendering of free services or services at substantially reduced prices) <sup>10</sup>.

The "American model" is the system of encouraging entrepreneurship and enrichment of the most economically active citizens. Its distinctive feature is that economic regulatory measures are geared toward only those aspects of reproduction spheres that cannot be regulated on the basis of free competition.

The same is true about the social security policy that should reimburse for all expenses so that to satisfy social needs of citizens.

The "American model of market economy" is characterized by smaller share of both budget expenditures in the GDP and social expenses. On the one hand, the above is caused by a totally different basic function of the taxation system: taxes are levied not only to redistribute incomes but also to influence prices and changes in demand and supply. For instance, the US taxation system provides for high ecological tax rates imposed on harmful enterprises.

On the other hand, the structure of public expenses is also different. Except for investments in the military and industrial complex as well as aerospace and other strategically important industries, public funding is much lower than usual but the amount of funds allocated for state purchases and maintenance of stable currency system is excessively high.

Distinctions of the American model also include anti-cyclic and anti-inflationary state interference with the market economy <sup>11</sup>. This model is based on high level of economic development as well as social and cultural national distinctive features, inclusive of mass orientation to personal success <sup>12</sup>.

As for features of the social market economy that would be expedient to adopt and introduce in Ukraine's economy, it is necessary to draw an analogy between contemporary economic situation in Ukraine and transitional states that were the first to embark on market economic reforms and transformations. After disintegration of the Soviet Union, our country inherited the command economy totally controlled by national authorities. The similar situation took place in Germany after the World War II. Compulsory establishment of industrial cartels, highly centralized management of enterprises and other restrictions imposed on economic entities alongside with the ruined economy of the post-war period forced Germany to look for the way out. For the above reasons, this country was the first to introduce and adhere to principles of the social market economy, the major of which were refusal from rigid administrative regulation of the economic sphere, its restructuring on the basis of priority of production of strategically important goods etc. The post-war Germany can serve as a good example for Ukraine in many aspects. However, we must not blindly imitate the German example. Ukraine's realities are absolutely different from inherent in the post-war German, since the German government never abolished or prohibited private property, whereas in our state, absence of the right for private property lasted for quite a long period.

Hence, under our national conditions, the public economic sector will be dominating over the private one for long. In such a situation, I would like to make analogies with development of Hungarian economy and mention a forecast of prominent Hungarian economist J. Kornai. In his opinion, over the next two decades, Hungary will be a country with the so-called double economy formed of the public and private sectors. The share of the public sector will decrease gradually. Taking the above into account, it is necessary to redouble efforts so that to accelerate this process and make it more effective. Although, there is no need to pin hopes for rapid transformation, as it is impossible to turn the public sector into the sphere of free entrepreneurship. The public sector will inevitably retain numerous negative features. Therefore, it would be much more expedient to form a favorable environment for development of the private sector understanding that this process will be slow. Proportions between the public and private sectors will gradually change for the benefit of the latter. Though, it is expected that those sectors will co-exist within a relatively long period<sup>13</sup>. We have to recognize that Kornai's prediction relating to development trends and future economic realities of Hungary is suitable for the all post-socialist states, as the same phenomena are observed in Ukraine.

So, building up Ukraine's economic model, we may not run to such extremes as blind imitation and formation of a unique national model, no analogues to which can be found in the world. The Ukrainian market must be controlled by introduction of a strong state policy ensuring sufficient support to socially unsecured groups of population.

The above objective can be achieved only through successful and effective combination of advantages and drawbacks of economic models the most appropriate for our country. I believe that the model of the Social Market Economy could serve as the best basis and determining paradigm of the end of XXth century. Ukraine's model of market economy to be developed on such paradigm should combine conditions for development of competitive economy, rigid economic regulation of the national market, strong state social policy, immunity and protection of private property. This model must provide for formation of the social market economy on the basis of the post-Soviet economy.

It is of paramount importance to determine market instruments of and mechanisms for restructuring and regulation of economy.

I would like to pay special attention to the following tools: the fiscal system, including sound and consistent taxation, emissive and customs policies; financing and crediting; strategy of reasonable interests rate; pricing mechanism providing for a definite proportion between fixed and flexible as well as wholesale and retail prices; various large-scale marketing arrangements focused on formation of economic demand of population; public investment policy; industrial output and structure of manufactured commodities, forms of their purchase and sales; production quotas; export and import policy; some mistakes that can be possible in the process of implementation of economic programs at the transitional stage etc. Without presenting an individual characteristic of the aforementioned factors, I would like to say a few words about realities with regard to those mechanisms for market regulation.

As far as the fiscal system is concerned, first and foremost, let me describe a contemporary taxation system. A lot of words, article and reports were dedicated to this problem! It is not a secret that our taxes dispelled hopes of Ukrainian entrepreneurs for high economic efficiency of their business. A positive fact is that the power understands the need for alleviation of onerous tax burden, reduction and flexibility of taxes. Respective government agencies have already worked out drafts of the new Taxation Code and other legal documents but their enactment is postponed because of unknown reasons.

Credits and loans play an imperative role in the market economy. This sphere of financial relations also experiences certain difficulties though they can be surmounted in the near future. Firstly, it is necessary to develop long-term crediting/financing of economy, including industries, and the state must do its best to encourage and stimulate this process. Secondly, it very important to cut down bank interest on credits/loans for economic entities. For instance, in Ukraine, bank interest on credits/loans amounts to nearly 30%, whereas in western economies it constitutes just 6-8%.

Marketing instruments are also very significant. Should those arrangements (for example, protectionist measures) make effect at the national level, it can turn out to be a rather powerful incentive to create a positive economic image of Ukraine. So, I would like to wish our government more resolution and courage to take those steps so that to support and protect national manufactures.

Of special note is the issue of state purchases of finished products. Notwithstanding long-lasting debates about efficiency of state orders, I guess any disputes to be inexpedient. The world experience demonstrated effectiveness of state orders. The latter are part and parcel of western economic systems. Practice proved that realization of policy of state orders by no means impedes normal functioning of market mechanisms. Therefore, the state must act as an active customer thereby encouraging general development of the national economy.

Ukraine's export and import policy must be firm but sober and well reasoned in view of the national interests. Despite everything, the state must protect and safeguard interests of any national manufacturer. One of the most illustrative examples is Ukraine's introduction of the VAT on Russian-made goods after the identical step on the part of the Russian Federation. Notwithstanding friendly political and other relations with any country, national interests must prevail. Nevertheless, Ukrainian exporters experience numerous problems. Nobody wants surrender positions in competitive struggle. Therefore, many countries initiated legal anti-dumping proceedings against Ukrainian exporters. However, we are still optimistic, as, in the long run, the strongest will occupy their niche in the international and world markets.

Nowadays, market regulation must represent the lion's share of activities of the Ukrainian government. Administrative regulation of the market should not be focused exclusively on the public sphere, whereas the private sector would appear to function on its own or suffer from various administrative and economic confinements. Except for monopolies, playing field should be leveled for all economic participants.

### Conclusions

The Ukraine's model of the social market economy requires co-existence of the strong state and the strong market. Hence, adoption of market orientation and intensification of market tendencies in economy must be attended with enhanced role of the state in the social security sphere. This model of social market economy calls for state care and guardianship. The state must carry out consistent and decisive policy targeted toward increase of living standards and social welfare. The afore-mentioned mechanisms for economic regulation are designed to reach those goals. Implications of economic transformations in Ukraine will strongly depend on efficient use of those instruments.

Approval of the above model will make Ukraine's economy more attractive. Firstly, it will contribute to formation of a socially oriented market based on production of essential goods. Secondly, the new model should provide for co-existence of the public and private sectors provided that they enjoy equal rights and any privileges are suspended. Thirdly, in the near future, the Ukrainian economy will be able to combine mechanisms for administrative and market regulation of economy. Fourthly, the state should prioritize development of the social sphere and it should constantly be under its patronage. Fifthly, if we want to live like western people, the state should resort to all possible means so that to foster the national market represented by Ukrainian manufacturers up to end of its intensive development.

I would like to stress the fact that formation of the state with efficient market economy will be possible only due to consolidation of efforts of all social groups, political parties and movements. At present, absence of concerted actions of citizens seriously hinders successful economic development of Ukraine. The social market economy model can and must serve as an economic basis of mutual consent and the common cause of all Ukrainian citizens for the purpose of ensuring prosperity in the independent Ukraine.

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## **Present Situation and Prospects for Development of State Regulation in Licensing of Economic Activities in Ukraine**

### **Summary of Focus Group Research**

On November 21, 2001, within the framework of the Information for Reforms Program, the Ukrainian Center for Independent Political Research and the Center for International Private Enterprise carried out a focus group research on “Present Situation and Prospects for Development of State Regulation in Licensing of Economic Activities in Ukraine”.

The focus group research objectives were as follows: *to evaluate the situation in the state policy realization in the sphere of licensing of economic activities, specify key problems in implementation of licensing legislation, point out main obstacles on this way and measures necessary for improvement.*

**The research was carried out using deep conjoint interviewing (a focus group method) and expert assessments. By the snow ball method a group of 8 participants including experts for state regulation in licensing of economic activities was composed. Experts representing different social sectors were involved in this group: representatives from central and local executive and legislative authorities, entrepreneurs and independent analysts, which made possible carrying out thorough and comprehensive study of the problems on the agenda.**

The focus group participants

**Volodymyr Barabash**, head of the board of directors of “Monomakh” Opened Joint-Stock Company

**Serhiy Bereslavsky** – expert at the Institute for Competitive Society

**Artur Hudkov** – head of the department of legal monitoring and legislation systematization in licensing and registration spheres of the State Committee of Ukraine for Regulatory Policy and Entrepreneurship

**Oleksandr Yefremov** – head of Central Registration and Licensing Administration of the State Committee of Ukraine for Regulatory Policy and Entrepreneurship

**Serhiy Moskvyn** – popular deputy of Ukraine

**Volodymyr Muzychuk** – head of the consolidated information department of the State Committee of Ukraine for Regulatory Policy and Entrepreneurship

**Serhiy Shcheda** - lawyer at the International Center for Prospective Researches

**Serhiy Tretyakov** – deputy head of the State Committee of Ukraine for Regulatory Policy and Entrepreneurship

**The research gave a great deal of information enabling to evaluate efficiency of the state policy in the licensing sphere in general, formulate key problems in legislation regulating licensing issues, as well as specify recommendations and measures to improve the situation in this sphere.**

**The obtained within the research materials are reliable can be used in practice for further quantitative researches and scientific analysis of the given problem.**

The research findings could be of interest to lawmakers, representatives of respective authorities, businessmen, academicians, journalists and wide public audience.

### **Research Summary**

*The research participants gave the following assessments to the situation in the state licensing policy in Ukraine:*

- The state licensing policy has been successful to certain extent, as it has been necessary to arrive at compromises in this sphere. In practice several licensing systems have been created. First of them is provided by the law on licensing of some economic activities, where certain activity is set as the object of licensing. The parallel licensing system has been created by special laws regulating certain activities, they also specify separate activities as the object of licensing. The third licensing system has been provided by those legal acts, which specify quite different objects of licensing, for instance, trading places or communication channels. One could say, that with creation of this system (a year ago) the state regulation in the licensing sphere has become efficient.



- The whole licensing sphere could be divided in two sections: firstly, licensing under the law on licensing of some economic activities, and secondly, licensing of other economic activities, which are not subject for licensing under the law on licensing. The set of provisions stipulated by the law on licensing could be assessed as to their correspondence to the present economic situation. From this view point, their ideology is seen rather progressive, as the basic principle of the state policy in the licensing sphere consists in the fact that a license is regarded as a non-fiscal instrument. For this, the order of licensing is hard to evaluate from the view point of its correspondence to the existing economic conditions. But regarding the principle of transparency and clearness, it is formulated rather properly. Besides, the list of economic activities subject for licensing is not adequate to the present economic situation in Ukraine.

- The one more sphere of licensing is institutions granting licenses, i.e. licensing institutions. They include the State Committee of Ukraine for Regulatory Policy and Entrepreneurship and separate ministries and departments. The State Committee of Ukraine for Regulatory Policy and Entrepreneurship does great deal of work associated with training of officers of licensing institutions, providing them with basic knowledge in the licensing sphere. The one more important institution is the Expert-Appellate Council, which is at present the most effective instrument for protection of entrepreneurs' rights not only in the licensing sphere, but in the sphere of economic activities in general.

***The research participants marked off the following breakthroughs in the sphere of the state licensing policy of Ukraine:***

- Adoption of the Law "On Licensing of Some Economic Activities" a year ago was timely and very important. One could say that in general, the state licensing policy corresponds to the present state of national economy.

- The law norms are properly formulated and are linked to the present life conditions. The law clearly defines the notions of a license and basic licensing principles, conditions expediency of their application and sets respective restrictions, points major activities subject for licensing. Besides, the law regulates the procedure of cancellation of a license, and such a notion as suspension of a license is abolished.

- Licensing was first introduced in Ukraine in 1991, then only 12 economic activities were subject for licensing. The licensing sphere was constantly expanding up to 1997: 212 economic activities and almost 1,5 thousand works were subject for licensing then. Almost everything was licensed. The present law specifies 61 economic activities subject for licensing and regulates licensing procedures. There are certain requirements as to compliance of an economic entity with license conditions, as well as documents to be attached to an application for a license etc. So, there is a proper legislative base regulating all licensing procedures. At the same time, instructions for licensing institutions have been systemized.

- Licensing is an instrument allowing to deprive an entrepreneur of the right to carry out certain activities using open and transparent procedure, if the entrepreneur does not comply to license conditions and violates the set by the law rules.

- Article 7 of the law provides for a progressive principle, due to which an economic entity, if considers actions by a licensing institutions groundless and illegitimate, has an opportunity to apply to a special collegiate body, which will qualify legitimacy or illegitimacy of action by a licensing institution and take a respective decision. The law stipulates two important provisions. Firstly, a decision of this collegiate body is regarded as an expertise. Secondly, under article 21 of the law a licensing institution' decision on cancellation of a license comes in force within 10 days upon it is taken. Thus, if an economic entity applies to the Expert-Appellate Council within this period, the licensing institution' decision on cancellation of the license can be suspended. Prior to enactment of this law, an economic entity was to apply to a tribunal, which entered its judgement upon trial. During such proceedings a plaintiff had no right to carry out activities specified in the license, as it was deemed cancelled. The trial could last for 2-3 months, during which a plaintiff was to cease his activities.

- Ministries have first made an attempt to adjust the list of the documents to be submitted for obtaining a license aiming at simplifying the procedure of obtaining licenses for entrepreneurs. And this is seen as a positive aspect. On the other hand, the State Committee for Regulatory Policy and Entrepreneurship has succeeded in canceling of at least half of groundless requirements set by respective ministries and departments.

- Even if license conditions only referred to legal acts to be followed by economic entities, it would still be a progressive step. Thus, an economic entity knows, what to refer and to pay attention to. Failure to comply with license conditions is one of the grounds for cancellation of a license. Specified and full list of legal acts provided in license conditions ensures the basis for disputing in cases of cancellation of licenses.

***The research participants outlined the following problems in the sphere of licensing of economic activities in Ukraine:***

- One of the key problems in the licensing sphere is reluctance of some ministries to pursue the set by the legislation provisions. Unfortunately, non of executive bodies appreciate clear and transparent norms. Each of them either misinterprets them and sets its own norms, or simply does not fulfil the set by the legislation requirements. The



State Committee for Regulatory Policy and Entrepreneurship has no powerful levers, using which, for instance, it would be possible to dismiss some official or hand in a case to a tribunal.

- Introduction of licensing should be motivated by some peculiarities in carrying out of certain economic activity, which could be a potential danger for the society. If, regarding this criterion, to analyze the provided by the law 61 economic activities, we will find that far not all of them match this criterion.

- At the same time, there is an urgent problem of unmotivated gradual narrowing of the scope of the law. If this tendency further develops, this law determining general guidelines of the state licensing policy and licensing order will regulate lesser number of economic activities. Thus, for today such spheres, as electric power and use of atomic power, trips (excursions), production and trade in alcohol, alcohol drinks and tobacco goods have been excluded from its scope. So, here a question arises, if there should be a common licensing policy, or we are to set special rules of the game for each separate field.

- The policy we pursue should be clearly outlined: is it aimed at reducing or growing of the state interference with entrepreneurship. Though a license should not be regarded as the means of just fiscal or administrative influence. It should become an indicator of high quality of activities carried out by a businessman. It is so in many fields. It is this ideology that is envisaged by the law – to set open and fair rules for relations between the state and entrepreneurs.

- The list of economic activities subject for licensing is seen the most problematic zone, as there could be at least two risks. On one hand, it is the risk of exclusion of some economic activities from the scope of the law on licensing. On the other hand – the risk of expanding of the list of activities subject for licensing. There is a tendency of their deepening. Thus, if the number of activities remains the same (61), their contents will still expand, as it has happened with postal, educational and transport services etc.

- There are urgent problems related to licensing of entities collecting metal scrap, radio channels, trade in alcohol drinks and medical practice.

- There is one more zone of risk associated with licensing conditions. The law sets certain parameters and restrictions for their approval. Licensing conditions should be approved taking into consideration Ukrainian laws, but they still introduce extra restrictions.

- The problem of delegating powers for licensing of some economic activities to local authorities still remains unsolved.

- There is possibility of automatic amending of article 9 of the law on licensing by other laws, which entails many problems. There is an eloquent example, when physical culture activities were added to the list of economic activities subject for licensing. Within two years the State Sport Committee has failed to define the object of licensing, so during this period no licenses have been granted.

- Licensing conditions for medical practice, gearing the right to carry out medical activities to the ownership status of medical institutions (state, communal or private), as well as territorial limitations for trade in medical remedies, are to be regarded as incorrect.

- The law on licensing does not provide for responsibility of licensing institutions for their actions, and this is seen its shortcoming.

***The research participants specified the following measures to be taken for improvement in the licensing sphere:***

- A special procedure for amending articles 2 and 9 of the law on licensing should be introduced, in order to prevent their automatic amending by other laws towards expanding the list of economic activities subject for licensing.

- The following practice should be introduced: a certain activity will be exempt from licensing, if within half a year no license conditions for it are elaborated.

- The following development of the situation in licensing would be desirable: the adopted law on licensing will be taken as the basis for the licensing sphere, and it will be further developed through elaboration of special laws regulating each separate field.

- The legislation should provide for the norm, which would oblige popular deputies to prove probability of treats to ecology, health of citizens or the state, which some economic activity proposed for licensing could bear.

- Maybe it would be reasonable to introduce the procedure for regular revision and analysis of legal acts regulating licensing. This could allow pursuing more adequate to the real situation in the national economy and entrepreneurship licensing policy and could be entrusted to the Expert-Appellate Council, for instance.

- Reasonable and gradual abridgement of the list of object of licensing is seen necessary.

- Adoption of the law is the first stage in the licensing system reformation. The second one is approval of license conditions. The third stage should be elaboration of final (detailed) license conditions.

- Enhancing civil activities of entrepreneurs and providing constant educational work in order to inform them of licensing backgrounds and innovations in this sphere is seen central.

## **Problems in Regional Economic Development in Ukraine**

### **Summary of Focus Group Research**

On December 13, 2001, within the framework of the Information for Reforms Program, the Ukrainian Center for Independent Political Research and the Center for International Private Enterprise carried out a focus group research on “Problems in Regional Economic Development in Ukraine”.

The focus group research objectives were as follows: *to evaluate the situation in realization of the national economic regional policy, specify key problems in regional economic development, propose measures for improvement of social and economic situation in regions, as well as effective mechanisms and instruments to be used.*

**The research was carried out using deep conjoint interviewing (a focus group method) and expert assessments. By the snow ball method a group of 10 participants including experts for regional and local economic development and state regional policy was composed. Experts representing different social sectors were involved in this group: representatives from central executive authorities, researchers, representatives from regional associations and independent analysts, which made possible carrying out thorough and comprehensive study of the problems on the agenda.**

The focus group participants

- Volodymyr **Bodrov** — head of the department of economic theory and history of economics of the Ukrainian Presidential Academy of Management
- Oleh **Boyko-Boychuk** — vice-president of the Association of Agencies for Regional Development of Ukraine, the Center of Social and Economic Development of Ukrainian Black Sea Area, candidate of economic sciences
- Volodymyr **Vakulenko** —municipal management department of the Ukrainian Presidential Academy of Management
- Vasyl **Zahorodniy** — head of the department of territorial economic systems and international business in regions of the Ministry of Economy of Ukraine
- Stepan **Kleban** — Association of Ukrainian Cities
- Zoya **Lutsenko** — the Union of Leaders of Local and Regional Authorities, assistant of the Secretary Office head
- Serhiy **Maksymenko** — East-West Institute
- Volodymyr **Sidushov** — Cabinet of Ministers of Ukraine
- Yevhen **Fyshko** — expert at the Institute for Reforms
- Viktor **Chuzhykov** — doctorant, Kyiv National Economic University

**The research gave a great deal of information enabling to evaluate efficiency of the state regional policy, as well as specify recommendations and measures for realization of social and economic development of Ukrainian regions.**

**The obtained within the research materials are reliable could be used in practice for further quantitative researches and scientific analysis of the given problem.**

The research findings could be of interest to lawmakers, representatives of respective authorities, businessmen, academicians, journalists and wide public audience.

#### Research Summary

*The research participants gave the following assessments to the situation in economic development of regions and regional policy in Ukraine:*

- Lately one could observe attempts by the government to find new innovative mechanisms, which would activate the intrinsic potential of regions. Earlier, the government had the experience of certain regional practice only, which was characterized by fragmentary solutions and absence of common policy. From now, it has started forming regional policy.
- The level of economic development of regions and main regional problems are inseparably connected with social and economic situation in the country in general.
- The problem of regional development, basing on the definition of concept of a region, is a system problem. Therefore, it automatically entails the problems related to institutions, personnel, resources, communications and environment. Use of development resources in regions could be evaluated as 2-3% from the volume available.

- Now, almost all Ukrainian territories are involved in strategic planning. The power has started solving the problem of regional development. There are programs for supporting business in almost in all regions. They out everything possible from the real legislation field. Regions should set more rigid requirements towards senior officials, who should anticipate emerging of problems instead of reacting to the problems accumulated.

- The state makes certain efforts to improve social and economic situation in regions. Adoption of the Budget Code of Ukraine has allowed to clearly distribute earnings between the state and local governments. Now, each local authority has its own income sources. The Code provides for income sources, which are not considered when determining inter-budgetary transfers. I.e., the earnings, which local governments receive to solve their local problems. This makes a considerable amount of UAH2 bill., i.e. 10% of the total of local budgets. Efficient spending of these funds depends on professionalism of local senior officials.

- There is a consensus as to necessity of decentralization of powers. Researchers and authorities have arrived at agreement to enhance the role of regions, expand their rights and opportunities in various political spheres. At that, new opportunities have been provided by the adopted Land Code. As local authorities themselves will solve the range of problems related to sale of land and land plots.

- Globalization of world economic processes, being a very important factor, has been underestimated. For instance, transnational corporations possess 4-5 times more money resources than all national banks together. Do we use this mechanism of influence on regions? It is necessary to pay attention to the factors of global money flows and conditions of investment attraction. As regions will not develop, if isolated, and one should not reckon upon the national budget.

- Today, the territories having special economic conditions make 10% of the whole territory of Ukraine. Analysis of the results of the previous year activities has been made, which evidences activation of economic activities on these territories. This can be also proved by investment dynamics, growing production, as well as by social problems solved. Investment growing has reached 225%, at that foreign investments make 40-50%. Direct foreign investments in these territories make approximately 20% of the total DFI all over Ukraine. Production growing has made 400%. The same tendency is proved by monitoring of the present year activities, though the situation is aggravated by the world economic crisis. Nonetheless, the volume of privileges granted to free trade zones and priority territories is more than the total of investments received.

- To evaluate activities of a free trade zone, the indicator received from division of the amount of privileges granted to entities working within special territories by the volume of Ukrainian nominal GDP is used. This indicator should not exceed 0,5-0,7. Last year this indicator has made 0,18, this year – 0,3.

- According to the Budget Code, external borrowings could be made by municipal councils and executive committees of municipal councils of the cities having population of no less than 800 thousand people. There are very few such cities in Ukraine, moreover, the law regulating such borrowings and mechanisms for their returning is to be elaborated. That is why, we should not reckon on external borrowings in solving the problems of local development.

- Municipal securities can be used as a source for covering the development budget deficit only. Under the Budget Code, only the cities being of certain regional and republican significance can have budget deficit.

*The research participants outlined the following key problems of economic development of Ukrainian regions:*

- The existing organizational forms authorities both at regional, local and central levels are inefficient and unsuitable for dynamic reformation of economic processes, which are under way in the regions today.

- Break of traditional economic links and ruining of the common national economic complex in the days of the Soviet Union has had extremely negative impact on the situation in the regions.

- For the last 10 years the difference between some regions has grown considerably. Thus, by the end of 2000, correlation between the indicators of maximal and minimal GDP in some regions has made 11 times, in investments activities – 12,3 times, social aid to the populace – 4,8 times, foreign investments – 46 times. The present difference in per capita income between different regions makes 35-45%, whereas up to international standards it should not exceed 20%.

- Profound changing of administration forms and methods is to be done to reorganize administrative vertical of authorities. It is necessary to provide for radical reorientation of administrative distributive functions of authorities for social and economic direction, i.e. for carrying out duties before the citizens.

- Accent on regional social and economic development and local administrative reform should not consist in new distribution of powers or shifts in personnel.

- The problem consists not only in improper state regional policy and mechanisms for its realization, but also in poor economic activity of local authorities and local governments.

- There is a problem of poor legislative base, i.e. its inefficiency in regulation of relations between local executive bodies and local governments.

- Local public servants lack in professionalism in solving economic problems.

- Use of regional resources for regional development is insufficient. Promoting regional development on a concrete territory, such regional resource as human resource is not appreciated as a social infrastructure.

- No municipal reform was carried out.
- There is no clear definition of the notion a “region of Ukraine” and regional division. Area – is an administrative unit of no more existent Soviet Union.
- The existing local taxes and duties can not create a real financial base for local and regional development.
- The budget reform has actually stopped at the district level, i.e. inter-budgetary relations between towns, small and large villages still remain unregulated. Here certain legal vacuum has been created.
- Local authorities almost do not involve private sector representatives and non-governmental organizations in solving local and regional problems. And these very sectors could be their real partners when rendering social services.
- Investment resources of the population are used insufficiently. For the last 3 years Ukrainian citizens have deposited about UAH 12 bill. alone with Ukrainian banks. Concession mechanisms are not used, amortization policy in enterprises needs improvement.
- Failure to adopt the common national program for social and economic development aggravates the process of development of programs for regional social and economic development.
- Agencies for regional development founded in the form of joint-stock companies are exposed to the risk to be “privatized” by governors. At that, dismissal of a governor entails ruining of the whole machine of monetary relations. That is why the Polish way is dangerous. It is necessary to found such agencies basing on civil organizations, which are less corrupted and operable institutions.

*The research participants specified the following measures to be taken for improvement of the situation in the state regional policy:*

- The state authorities should clearly outline both the strategic and final objectives of regional administration system reformation and regional development of Ukrainian transition society. It should not lay the burden of economic reforms on regions. It should involve intrinsic development capacities of a region in the process of general national economic growth, encouraging broader and more efficient use of local labor, intellectual and other resources.
- There is a need in new regional policy, which would provide for reorganization of the administrative vertical through expanding powers and opportunities of local authorities, as well as economic opportunities and responsibilities of regional authorities by means of deep reformation of the administrative forms and methods. This is radical reorientation from administrative-distributive functions to economic and social ones, i.e. to carrying out social duties.
- The following laws are to be elaborated and adopted: on the state regional policy, on local finances, on territorial division, on planning territories, on territorial communities, on local state administrations. A program for development of local governments should be worked out.
- Along with the state regional policy, each region should have its own development policy, as well as local government policy, which are also to be realized.
- Realization of the concept of the state regional policy should be agreed with other reforms in the country, namely with administrative, administrative-territorial, budget, municipal and tax reforms.
- There has been voiced an idea to set up an executive body in Ukraine, which would be responsible for elaboration and realization of the state regional policy under the draft name Ministry of Regional Policy.
- It is necessary to search for ways and instruments for creation of favorable conditions for those people, who possess money and would like to invest them in local infrastructures.
- In many countries real estate tax makes half of all earnings to local budgets. This is the most important basis for a local financial base. The problem of communal property legal status should be solved at the local level. Communal property issue should be regulated.
- It is necessary to develop cooperation of Ukraine with Russia, Belarus, Moldova, Poland etc on neighboring territories.
- Local budgets of development and municipal development funds should be provided. These resources are rather small, but their availability would positively influence on investment climate of a region.
- It is seen necessary to encourage developing of different forms of local businesses, which could allow solving problems emerging in the result of restructuring of large enterprises-manufacturers.
- Emerging problems of regional cycles should be studied and traced. In Western Europe regional DP indicators and social cluster systems comprising the set of special social indicators are used.
- Regional economic policy aimed to provide the people with equal (not similar) life and self-realization conditions. Here there a question arises, if economic development of regions should be improved by any means whatsoever?
- It is seen necessary to set up institutions, which would deal with regional development, for instance, regional development agencies, being professional and independent institutions providing real services.

- We work under conditions of extreme uncertainty in administrative decision-making sphere. So the only efficient technology is to allow those regions, which have managed to find a successful algorithm, to develop it into a general scheme that could be practiced by other regions. This is the so-called crossing point of successful solutions.
- Technology consisting in creating a probation ground for administrative solutions, provided minimization of the state interference and delegation of controlling powers to regional bodies, should be used. It is seen the most effective way to arrive at prompt and successful decisions, which could be further implemented all over the country.